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Taxation, Responsiveness and Accountability in Sub-Saharan Africa

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November 2010

I hereby declare that this thesis has not been and will not be submitted in whole or in part to another University for the award of any other degree.

Signature.....

WILSON PRICHARD

DOCTOR OF PHILOSOPHY

TAXATION, RESPONSIVENESS AND ACCOUNTABILITY IN SUB-SAHARAN AFRICA

SUMMARY

This thesis explores the argument that the need for governments to raise tax revenue, as opposed to relying on resource rents or other sources of non-tax revenue, may increase the likelihood that they will be responsive and accountable to their citizens. It employs a combination of quantitative and qualitative methods, first testing the relationship between tax reliance and accountability econometrically using cross-country data and then turning to detailed case studies from Ghana, Kenya and Ethiopia. The econometric results conclude that while existing data is consistent with the argument that tax reliance contributes to greater responsiveness and accountability, it is not possible to establish causality due to a combination of data limitations and the complexity of the underlying causal processes. This ambiguous finding provides motivation for the detailed case studies that follow. The causal model developed here proposes that the need for governments to rely on taxation may strengthen taxpayer demands for responsiveness and accountability, owing to the possibility of tax resistance and the role of taxation as a catalyst for collective action. Consistent with this model, the case study chapters present detailed historical narratives that capture significant examples from each of the three countries in which the need for taxation has contributed significantly to the expansion of responsiveness and accountability. As importantly, the case study evidence provides a nuanced understanding of the nature of the connections between taxation, responsiveness and accountability, highlighting three distinct types of causal processes at work, as well as the most significant social, political and economic contextual factors that shape the potential for tax bargaining. These lessons point toward important policy implications for foreign aid and tax reform more broadly.

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Acronyms

ADI	Africa Development Indicators
AGI	Association of Ghana Industries
CDF	Constituency Development Fund
CEPS	Customs, Excise and Preventive Service
CGD	Centre for Governance and Development
CJA	Committee for Joint Action
CMB	Cocoa Marketing Board
COMESA	Common Market for Eastern and Southern Africa
CVC	Citizens Vetting Committee
EPLF	Eritrean People's Liberation Front
EPRDF	Ethiopian People's Revolutionary Democratic Front
EPRP	Ethiopian People's Revolutionary Party
ERP	Economic Recovery Program
ETR	Electronic Tax Register
FGLS	Feasible Generalized Least Squares
GET	Ghana Education Trust
GFS	Government Financial Statistics
GMM	Generalized Method of Moments
GPRTU	Ghana Public Road Transport Union
GPT	Graduated Personal Tax
GUTA	Ghana Union of Traders Association
HIPC	Highly Indebted Poor Countries
ICRG	International Country Risk Guide
IFI	International Financial Institution
IMF	International Monetary Fund
IRS	Internal Revenue Service
KARA	Kenya Alliance of Resident Associations
KEPSA	Kenya Private Sector Association
KLDA	Karen and Langata District Association
KRA	Kenya Revenue Authority
LDV	Lagged Dependent Variable
LTU	Large Taxpayers Unit
Meison	All-Ethiopia Socialist Movement
NARC	National Rainbow Coalition
NDC	National Democratic Congress
NHIL	National Health Insurance Levy
NHIS	National Health Insurance Scheme
NISCOF	Nairobi Informal Sector Confederation
NPP	National Patriotic Party
NRL	National Reconstruction Levy
NRS	National Revenue Secretariat
NTA	National Taxpayers' Association
ODA	Official Development Assistance

OECD	Organization for Economic Cooperation and Development
OLS	Ordinary Least Squares
OPEC	Organization of the Petroleum Exporting Countries
PA	Peasant Association
PCSE	Panel Corrected Standard Error
PNDC	Provisional National Defence Council
RML	Road Maintenance Levy
SME	Small and medium enterprise
TMP	Tax Modernization Program
TPLF	Tigray People's Liberation Front
TSCS	Time-Series Cross-Section
UBA	United Business Association
VAT	Value Added Tax
WB	World Bank
WCDI	We Can Do It
WDI	World Development Indicators

1. Taxation, Revenue and Development: An Introduction

In 1918 Joseph Schumpeter (1991 [1918]: 101), a pioneer in the field of fiscal sociology, wrote that, “public finances are one of the best starting points for an investigation of society, especially although not exclusively of its political life.” Central to his argument was the belief that the way that governments were funded was fundamental to understanding the way that society was organized and governed. A government that was forced to rely on its citizens to for revenue through taxation was likely to rule very differently, and to face very different political pressures, than one which could draw on independent resources to finance its activities.¹

This basic insight has been borne out by accounts of state formation in early modern Europe, many of which have traced the emergence of representative political institutions in part to conflicts between citizens and governments over taxation. In some states monarchs were forced to cede rights and political power to taxpayers in order to secure compliance with taxation. In others conflict over taxation became a catalyst for broader public mobilization and political conflict, thus providing a spark for profound political changes. While the need for taxation did not prompt such political changes everywhere, it is widely accepted that in a significant number of cases the need for governments to raise tax revenue strengthened taxpayers demands for greater political responsiveness and accountability (Tilly 1990).

Despite the centrality of taxation to accounts of state formation and political change in early modern Europe, questions about taxation have historically figured much less prominently in the study of politics in the developing world (Moore 1998). This, though, has begun to change, as research focused on the connections between revenue and politics in the developing world has gained greater prominence over the past decade in particular. Most of this comparatively recent work has centred on the broad argument that states that rely heavily on non-tax sources of revenue are more likely to be autocratic and corrupt, while

¹ Equally central to the evolution of scholarship in this field was the work of Rudolf Goldscheid. Unfortunately, little of that work has been translated into English, though it is summarized in Schumpeter (1991 [1918]) (Moore 2001: 399-400).

those that are more reliant on tax revenue are more likely to be responsive and accountable to their citizens. In simpler terms, a significant body of research has proposed the existence of a “resource curse,” with access to extensive natural resource wealth leading to deteriorating governance and development outcomes. These ideas initially emerged largely from the experience of so-called Rentier states in the Middle East and North Africa, where the discovery of significant oil resources was accompanied by the spread of autocratic rule and the weakening of many state institutions (Mahdavy 1970, Chaudhry 1997, Vandewalle 1998). More recently, scholarly attention has also turned to sub-Saharan Africa, where resource rich nations have frequently suffered from autocracy, high levels of corruption, low levels of economic growth and devastating episodes of civil war (Guyer 1992, Yates 1996, Herbst 2000, Collier and Hoeffler 2000, Bates 2001).

The proliferation of studies in this area has yielded broad agreement that access to significant resource wealth can pose a significant risk to the quality of governance and to broader development outcomes (Ross 2001). However, while there has been broad agreement on this general message, scholars have offered a comparatively diverse array of explanations for this connection. For some the problem lies in the tendency of resource wealth to encourage aggressive competition for control of the state, often through armed conflict (Collier and Hoeffler 2000, 2009). For others the central issue is that resource wealth offers extensive opportunities for corruption, and thus tends to reinforce political strategies based on patronage and rent-seeking (Kolstad and Wiig 2009). For still others, the key issue is that resource wealth reinforces the power of the central state, allowing governments to purchase political support and punish political opposition through repression (Morrison 2009).

While these explanations are diverse, they share a primary focus on the potentially negative consequences of resource wealth, through its ability to distort political incentives and political competition. An alternative tradition, which motivates this thesis, has argued that access to extensive non-tax revenue may reduce the quality of governance by reducing the need for governments to collect tax revenue from their citizens. This possibility rests on the belief that the need for governments to collect tax revenue can strengthen their dependence

on their citizens, thus generating positive incentives for governments to build strong state institutions, to provide conditions conducive to economic growth, and, perhaps most importantly, to be more responsive and accountable to taxpayers (Levi 1988, Moore 1998, Bates 2001).

In recent years arguments about the importance of tax reliance to the emergence of effective governance have become increasingly accepted, even being taken for granted in at least some popular writing on development. For example, Paul Collier, who has emerged as one of the best-known voices in the field, has written that (2009:126):

It is also evident why natural resources might increase proneness to violence. They provide a ready source of finance for rebel groups, they provide a honey pot to fight over, *and they enable the government to function without taxing the incomes of citizens, which gradually detaches it from what citizens want [my emphasis]*.

This argument has also increasingly appeared in debates about foreign aid, with growing concerns that foreign aid may reduce the need for domestic taxation, and thus inadvertently undermine domestic pressure for the emergence of responsive and accountable governance. Thus, in a recent review article Moss, Pettersson and van de Walle (2006:14) propose that:

Large aid flows can result in a reduction in governmental accountability because governing elites no longer need to ensure the support of their publics and the assent of their legislatures when they do not need to raise revenues from the local economy, as long as they keep the donors happy and willing to provide alternative sources of funding.

Thus, after a long period of neglect, the importance of taxation to state-society relations and broader governance outcomes in the developing world has begun to gain attention in both academic and policy debates.

However, despite this increasing attention, the empirical basis for these claims has remained surprisingly underdeveloped. Empirical support for the existence of a positive relationship between taxation and broader governance gains continues to be based primarily on the well-accepted importance of tax conflicts to state formation and political reform in early modern Europe (Tilly 1990), and on the absence of responsiveness and accountability in many resource dependent states (Ross 2001, 2004). This evidence is certainly *suggestive* of a relationship between the need for taxation and improved governance in contemporary developing countries, but it ultimately remains highly incomplete. Historical evidence, while it offers valuable conceptual guidance, is far from constituting proof that similar processes are likely in the vastly different context of contemporary developing countries (Moore 1998, 2008). Meanwhile, the absence of good governance in many resource dependent countries is *consistent* with the argument that the need for taxation strengthens incentives for good governance, but may equally reflect the many other channels through which resource wealth may shape political outcomes. Finally, cross-country econometric studies by Ross (2004) and Mahon (2005) are perhaps the best-known evidence cited in favour of a connection between taxation and accountability in the contemporary developing world, but there are major questions about the econometric robustness of these results (Haber and Menaldo 2009).

More glaring than questions about the robustness of existing evidence is the simple absence of systematic qualitative evidence exploring the role of taxation as a spur to broader governance gains at the country level. This is particularly striking given that historical evidence of a relationship between taxation and political reform in early modern Europe is based almost entirely on narrative accounts of conflicts over taxation in individual countries. Such qualitative accounts are essential for at least three reasons. First, they are the most effective means to capture the specific impact of the need for taxation on the quality of governance, as distinct from other pathways through which alternative sources of government revenue may shape the state and political outcomes. Second, they are able to capture the potential diversity of political processes linking taxation to improvements in governance. Finally, they can provide the type of detailed evidence necessary to inform policy debates aimed at strengthening linkages between taxation and improved governance.

Given the various limitations of existing evidence, this thesis empirically investigates one aspect of the relationship between the need for taxation and broader improvements in governance, focusing on the relationship between taxation and the emergence of responsiveness and accountability in three countries in sub-Saharan Africa: Ghana, Kenya and Ethiopia. It thus explores the argument that the need to rely on tax revenue may lead governments to enter into "tax bargains" with citizens, conceding greater responsiveness and accountability in order to secure acceptance of, and compliance with, taxation (Moore 2008:36). Put slightly differently, it explores the possibility that the need for governments to collect tax revenue may strengthen the ability of citizens to make successful demands for responsiveness and accountability. This argument, in turn, reflects two interrelated causal logics: first, governments that are forced to rely on tax revenue may face stronger incentives to make governing concessions to citizens in order to improve tax compliance and collection; second, citizens that are subject to taxation may take a more active interest in how that revenue is spent, and thus make more active demands for reciprocal concessions from government.

The thesis ultimately has three broad goals. First, it asks whether there is evidence that the need for governments to tax their citizens has, in fact, contributed significantly to the expansion of responsiveness and accountability in Ghana, Kenya and Ethiopia. This marks the first sustained effort to explore the empirical validity of arguments about tax bargaining at the country level in the developing world.

The second goal is to better understand the specific pathways through which the need for taxation may shape political interactions and outcomes at the country level. Rather than focusing on general claims about taxation, responsiveness and accountability, this thesis aims to understand how, precisely, taxation has contributed to political change in practice. Such specificity is not only of academic interest, but is indispensable in order to eventually translate general lessons into specific policy implications.

Finally, the third goal of the thesis is to highlight the most important contextual factors that have shaped the relationship between taxation, responsiveness and accountability. This is particularly important, as the thesis does not claim that the need for taxation will *always* result in improved responsiveness and accountability, but, rather, seeks to demonstrate the more modest empirical claim that the need for taxation has contributed to the expansion of responsiveness and accountability in a significant number of specific instances. As such, there is substantial value in highlighting the specific circumstances under which the need for taxation is, or is not, likely to become a catalyst for broader governance gains.

In pursuit of these goals, the thesis begins by proposing a detailed theoretical model linking taxation to the expansion of responsiveness and accountability. While the model developed in this thesis draws on existing models of tax bargaining, it expands upon earlier work in two important ways. First, while earlier models have treated tax bargaining as a quite distinct political process (Gehlbach 2008), the model developed here seeks to integrate the study of taxation with broader models of political change and reform. Second, the model developed in this thesis is more expansive than existing formal models, and is correspondingly able to capture a broader variety of outcomes.

Specifically, this thesis argues that the political relevance of taxation is best understood through the lens of political power. The need for governments to rely on taxation can be understood as effectively increasing the political power wielded by citizens, and consequently their ability to make demands on governments for responsiveness and accountability. In framing the issue in this way, this thesis aligns itself with more general theories of politics that view political outcomes largely as the result of political contestation between citizens and those elites who control the state (Acemoglu and Robinson 2006, Moore 2007). Having adopted this general framing, the model developed here moves beyond earlier works by explicitly identifying multiple alternative causal processes by which the need for taxation may contribute to the broader expansion of responsiveness and accountability. It argues that the need for taxation may increase the political power wielded by citizens by allowing them to gain political leverage over the government through *tax resistance*, and by encouraging and strengthening *political engagement and collective*

action. These political actions by taxpayers may, in turn, lead governments to make explicit governance concessions (termed *direct tax bargaining*), or may have a more indirect and long-term effect on the likelihood of political reform by weakening unpopular incumbents and strengthening political engagement (*indirect tax bargaining*).

With this theoretical model in place, the empirical analysis proceeds in two parts. The first part replicates and expands upon existing cross-country econometric evidence. This is an important first step, as econometric evidence has played a prominent role in shaping existing understanding of the issues being examined here, but is also subject to significant scepticism resulting from highly uncertain data and methods (Haber and Menaldo 2009). In line with these critiques, the analysis presented here concludes that while available data is *consistent* with the belief that taxation can be a catalyst for the expansion of accountability, *it does not provide a sufficient basis for conclusively establishing the existence of a causal relationship*. As importantly, such econometric evidence is unable to capture the specifics of how reliance on tax revenue shapes broader governance outcomes, and is thus unable to distinguish between multiple competing causal arguments.

The uncertainty of available econometric results sets the stage for the primary contribution of the thesis, which lies in developing case study analyses of the relationship between taxation and political reform in Ghana, Kenya and Ethiopia. Consistent with studies of early modern Europe, the analysis is based on the construction of detailed analytical narratives of taxation and political change in each of the case study countries.

Ultimately, the thesis argues that there is substantial evidence across the three cases that the need for taxation has contributed to the expansion of responsiveness and accountability by effectively strengthening the political power wielded by taxpayers. This evidence is captured in political narratives, both big and small, that speak to the potential centrality of taxation to political change. In one case, a former military government in Ghana introduced a new goods and services tax in the mid-1990s and was confronted by mass political protests. These protests resulted in the repeal of the tax and, more importantly, catalyzed popular demands for political liberalization and aided the emergence of more genuinely

democratic governance. In a quite different episode in Kenya taxpayers responded to the corruption and undemocratic behaviour of an incumbent government through purposeful tax resistance and evasion, which helped to weaken the fiscal position of the government. This revenue pressure eventually contributed to a change of government, and dramatic governance reforms. Collectively, these and other examples suggest that an important explanation for political developments in these countries may be found in the efforts of governments to extract tax revenue from their citizens.

While the thesis thus highlights the importance of tax reliance to broader political developments in each of the three countries, it equally makes clear that the relationship between taxation and political reform is far from automatic. For every instance in which the need for taxation has contributed to the expansion of responsiveness and accountability, there are other cases in which increased taxation has been imposed coercively, without resulting in any meaningful concessions from governments. Thus an important part of the research contribution lies in highlighting the specific features of country-level processes linking taxation, responsiveness and accountability, as well as the contextual factors that have shaped particular outcomes. While country-level processes have sometimes involved relatively explicit tax bargaining between taxpayers and governments, taxation has just as often shaped political outcomes through relatively implicit and indirect processes. Meanwhile, particular processes and outcomes have been shaped by a diverse set of contextual variables, ranging from broad political and economic factors to more specific issues related to public policy and the activities of civil society. These latter factors are of particular interest because they point towards potential strategies for strengthening the links between taxation, responsiveness and accountability in the contemporary developing world.

Having laid out the broad argument of the thesis, the remainder of this introductory chapter is organized as follows. The next section situates this research with respect to broader research about politics and governance in the developing world. The section that follows then positions this research within the context of broader studies of the relationship between alternative sources of government revenue and governance outcomes. This is followed by a more detailed review of existing research dealing with the relationship between taxation,

responsiveness and accountability, thus highlighting the specific research contribution made by this thesis. Finally, the chapter concludes by introducing the research methodology and presenting a full outline of the thesis.

1.1. Politics, Institutions and Development

Despite growing interest in the relationship between taxation and governance outcomes, research in this area remains in its infancy, and detailed attention to tax and revenue issues remains the exception, rather than the rule, in broader discussions of governance and political reform in the developing world. This reflects, at least in part, the tendency of much development research to focus on identifying those policies and institutions most conducive to development, while paying comparatively less attention to state-society relationships and the underlying political processes that ultimately shape policies and institutions.

Historically, development research frequently focused on the realm of policy, reflecting a belief that rapid development would result from ‘getting policies right’. In sub-Saharan Africa this tendency has been reflected in the policy prescriptions associated with structural adjustment in the 1980s and 1990s, and in the general convergence of economic and social policies over time. While interest in policy remains significant, the past two decades have witnessed a progressive shift away from a narrow focus on policy and towards a greater attention to the importance of the state and of institutions in shaping development outcomes. This shift has reflected a growing recognition that simply getting policy right was insufficient for achieving rapid economic development where states were not genuinely committed to pursuing developmental outcomes, and capable of delivering on that commitment. This view is clearly captured by Atul Kohli (2004: 12), who writes on the question of economic development that,

The nearly exclusive focus in the literature on appropriate policy choices is incomplete, even misleading. Policy choices matter, of course, but these choices must be explained. More important, the impact of the same policy applied in two different settings may vary because of the contextual

differences ... the contextual difference that deserves emphasis ... concerns the varying political and institutional conditions in which economic policies are chosen and pursued.

The result of this shift in emphasis has been the proliferation of studies arguing that political and economic institutions are the crucial determinants of development outcomes. As one leading scholar in the field has put it, “the most convincing theory of comparative economic development asserts that it is institutions that are the fundamental cause of countries’ development or underdevelopment” (Robinson 2002: 510).

Within the realm of politics, research has tended to focus on the implications of particular formal and informal political institutions for state behaviour and development outcomes. This has yielded studies of relatively formal political institutions including elections, parliaments, decentralization and political party systems (Lindberg 2006, Crook and Manor 1998, Acemoglu and Robinson 2006). It has also yielded broader consideration of informal rules and norms governing bureaucratic practices and the exercise of political power (Bratton and van de Walle 1994, 1997).

Collectively, this literature has made a powerful case for the importance of political institutions to broader development outcomes, and has pointed towards the need for research to explain the origins of these institutions. To a greater degree than in other regions, explanations of the origins of political institutions in sub-Saharan Africa have tended to focus on history, and particularly on the legacy of colonial rule. In simplified terms, such studies have generally argued that difference in the nature of colonial rule produced unique institutional legacies, which have, in turn, yielded differing development trajectories (Mamdani 1996, Acemoglu, Johnson and Robinson 2001, Kohli 2004, Lange 2009). These studies of the historical origins of contemporary institutions have immensely enriched our understanding of politics in the region, but the focus on the importance of colonial rule, however justified, has implied comparatively less attention to those other forces that have shaped states, state-society relations and political systems.

It is correspondingly useful to turn to consider the vast literature that has sought to explain the origins of political institutions, and particularly democracy, more broadly.² While this literature encompasses significant diversity, much of it implicitly or explicitly rests on a simple model of politics in which political reform results from conflicts between citizens and elites, as those outside of government seek to gain greater control over the state (Acemoglu and Robinson 2006). While the details of particular processes of political liberalization are likely to reflect specific elite conflicts and strategic decision-making (O'Donnell and Schmitter 1986, Haggard and Kaufman 1997), in broader terms the expansion of accountability is expected to turn on the ability of citizens to make effective demands on governments. While some theories have emphasized the particular importance of the middle class to such processes (e.g. Moore 1966), and others have stressed the importance of more broadly based political mobilization (e.g. Rueschemeyer, Stephens and Stephen 1992), it is in both cases concerted and organized political demands that generate the need for political reform. In the words of Acemoglu and Robinson (2006: 29):

“Democracy is usually not given by the elites because its values have changed. It is demanded by the disenfranchised as a way to obtain political power and thus secure a larger share of the economic benefits of the system.” Viewed through this lens, the long-term strengthening of institutions that promote responsiveness and accountability is expected to depend on processes that increase the political power wielded by citizens. This basic logic lies behind arguments that variously emphasize the importance of economic growth, industrialization, globalization or the increasing organization of civil society to long term political transformations. There is thus a rich literature that views the emergence of political institutions that promote responsiveness and accountability as the outcome of increasingly effective demands by citizen groups outside of government. These accounts, in turn, have frequently argued that shifting social and economic conditions have been integral to strengthening the effectiveness of popular demands.

² These studies have often paid remarkably little attention to experiences in sub-Saharan Africa. While this undoubtedly owes largely to the relatively brief recent history of democracy in the region, it is nonetheless noteworthy. In the highly influential recent work of Acemoglu and Robinson (2006), for example, there is virtually no attention paid to recent experiences in sub-Saharan Africa (outside of South Africa), while much of the most widely cited literature on democracy in the developing is based heavily on Latin American experience.

While this tradition thus offers a valuable framework for understanding political change, a slightly different intellectual tradition has instead sought to explain the emergence of political institutions as part of broader processes of state formation and state building. Broadly speaking, research in this tradition proposes that the emergence of political institutions is best understood as the outcome of efforts by states to address the most fundamental requirements of statehood: controlling violence, waging war and raising revenue.³ Best known within this tradition are works that have traced the evolution of political institutions to the efforts of states to respond to the external threat of war. These works have argued that meeting the threat of war required dramatic improvements in state capacity and forced domestic groups to arrive at new political compromises. In many cases, the threat of war thus led governments to become more responsive and accountable, primarily to elites, in order to secure the resources and support necessary for waging war. The broad logic of these studies is captured in Tilly's (1975: 42) oft-quoted claim that "war made the state and the state made war." However, while studies in this tradition have played a major role in shaping our understanding the history of political change in the developed world, they have generally played only a secondary role in the study of politics in the developing world (Centeno 1997, Doner, Ritchie and Slater 2005). This approach is nonetheless reflected, for example, in a small number of studies that have traced the weakness of states in sub-Saharan Africa to the absence of the threat of interstate warfare (Jackson 1991, Herbst 2000).

Of particular interest within this broad intellectual tradition is the work of Charles Tilly (1990), who has linked the broad influence of war to a detailed consideration of the importance of government revenue to the development of the state and political institutions. Focusing on experiences in early modern Europe, he has argued that the escalating costs of

³ A recent contribution within this broad tradition, which is not addressed in detail here, comes from North, Wallis and Weingast (2009). They argue that the basic problem facing states is the need to limit violence among competing claimants to power. Thus, the political institutions that emerge represent an elite bargain capable of limiting violence and promoting social order. Within this framework, the emergence of political institutions that foster responsiveness and accountability (what they term the emergence of "open access orders") occurs when such a development serves the interests of elites, and proves to be an effective means to limit violence and sustain social order. While compelling, this framework has not as yet been directly employed to explain contemporary processes of political change, and thus offers limited guidance as to specific forces that may make the emergence of responsive and accountable governance more likely.

warfare forced states throughout Europe to increase the taxation of their populations, with major consequences for political institutions and the broader character of states. In some cases, and most famously in England, the need for tax revenue led states to enter into ‘tax bargains’ with citizens, as taxpayers accepted significantly expanded taxation in exchange for the strengthening of representative institutions and other checks on the power of monarchs. While similar outcomes were by no means universal, important links between taxation and political reform were also evident elsewhere in Europe - most notably among the Dutch and the French - and this broad narrative has correspondingly found significant support amongst scholars (Ertman 1997, Daunton 2001, Levi 1998, North and Weingast 1989).

While Tilly’s work has thus emphasized the importance of taxation to the character of the state and political institutions, his account nonetheless maintains a strong emphasis on the centrality of warfare to processes of political change. By contrast, Schumpeter (1991 [1918]), and others within the broad tradition known as fiscal sociology have proposed significantly more general claims about the centrality of government revenue to the evolution of politics and the state. Studies within this tradition have argued that, independent of the threat of warfare, how governments are financed is likely to have important implications for how they are governed. Most centrally to this study, they have argued that the need for states to raise tax revenue is likely to make them more dependent on their citizens and thus more likely to be responsive and accountable (Moore 2001).

This study falls squarely within this broad tradition, while drawing heavily on the model of ‘tax bargaining’ that emerges most clearly from Tilly’s work. At the same time, an important contribution of this work lies in linking the analysis, grounded in fiscal sociology, relatively explicitly to more conventional models of contestation and political change in the developing world. Thus, this thesis understands the emergence of institutions of responsiveness and accountability as the outcome of contestation between citizens and states, but is explicitly focused on the impact of the need for taxation on the political power wielded by taxpayers, and on their consequent ability to demand responsiveness and accountability from governments.

1.2. Revenue and Governance

The preceding discussion has aimed to situate this study within the broader context of research on governance in sub-Saharan Africa and the developing world more generally. Having thus framed this research in very broad terms, this section is focused on situating this thesis within the more specific context of research dealing with the connections between government revenue and governance across the developing world. While this thesis is concerned specifically with the possibility that the need for taxation may contribute to the expansion of levels of responsiveness and accountability, this is only one of many pathways through which alternative sources of government revenue may shape the state, institutions and political outcomes. It is correspondingly important to understand where the research questions being posed here fits in relation to this broader field of inquiry.

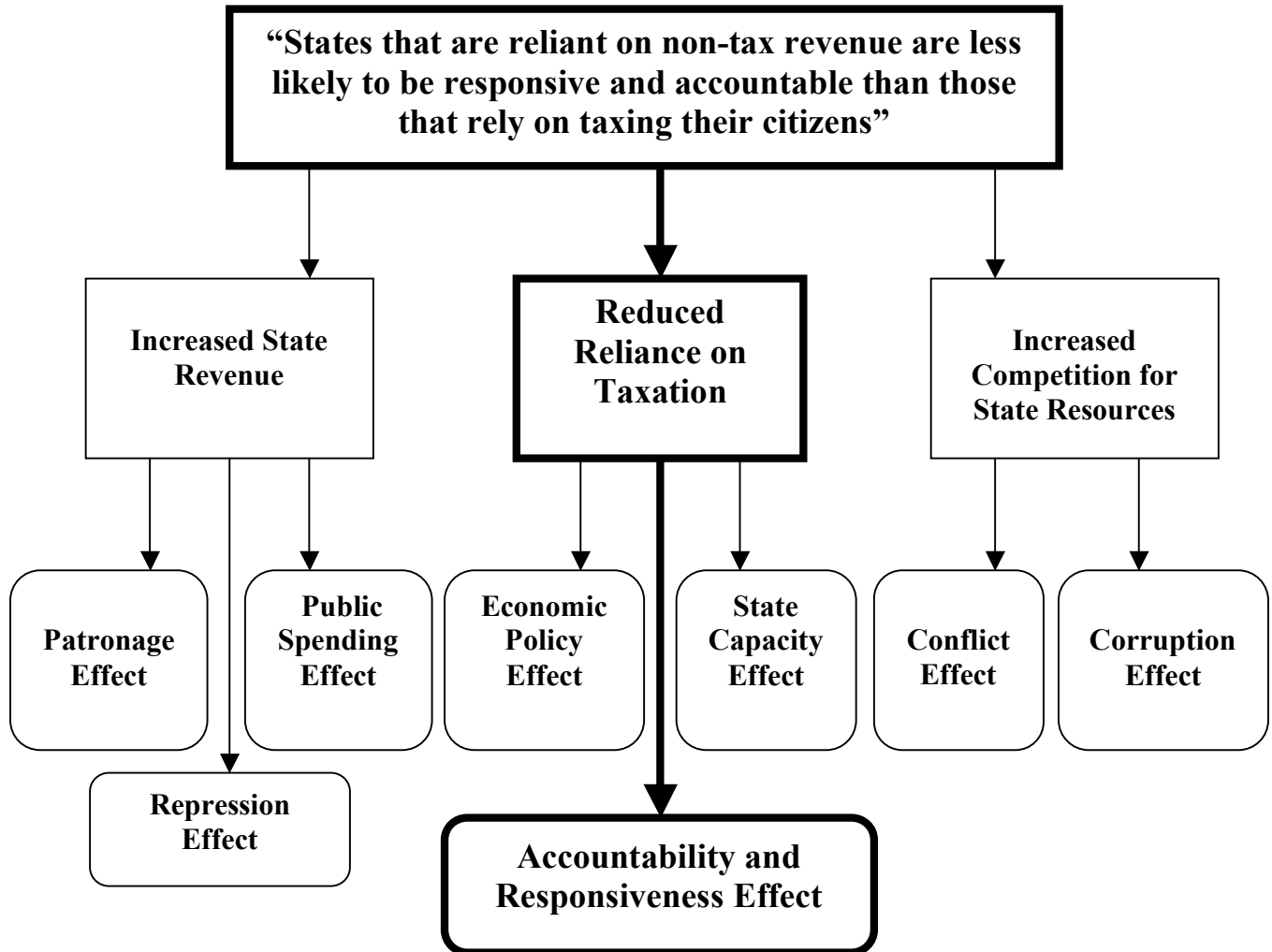
Research addressing the connections between revenue and governance has overwhelmingly focused on the broad argument that governments that are more reliant on tax revenue are more likely to be effective, responsive and accountable, while those that rely heavily on non-tax sources of revenue are more likely to be autocratic and corrupt. In this context the term ‘tax reliance’ refers to the *share of tax revenue in total government revenue*, and is thus determined by *both* levels of tax collection and the extent of non-tax revenue (Ross 2004). All else being equal, tax reliance declines when either the level of tax collection declines or the level of non-tax revenue increases.

This definition of tax reliance provides a useful basis for comparing multiple political units, and for asking whether those that are more tax reliant tend to experience greater state capacity, responsiveness and accountability. Unfortunately, because the concept of tax reliance encompasses two distinct elements - levels of tax collection and the extent of non-tax revenue - it is somewhat ambiguous if our goal is to explain *why* certain governments are more capable, responsive and accountable than others. Most importantly, is poor governance primarily the result of high levels of non-tax revenue or of low levels of taxation? More specifically, how does access to significant non-tax revenue shape political behaviour and outcomes? Likewise, how, specifically, does the need for taxation shape government behaviour? There are multiple pathways through which tax reliance may be

linked to governance outcomes, and these differing possibilities carry with them potentially distinct policy implications. It is consequently very useful to divide the broad argument that states that states that are more reliant on taxation are more likely to be capable, responsive and accountable into a set of more specific arguments linking alternative sources of government revenue to particular governance outcomes. Doing so is not only conceptually important, but provides a firmer basis for detailed and rigorous empirical investigation of these issues.

While there are potentially multiple ways of organizing this broad literature, the approach adopted here is laid out in Figure 1.1. This categorization divides existing explanations into three broad categories, each of which, in turn, encompasses two or three specific causal pathways linking revenue to governance outcomes.

Figure 1.1: Pathways Linking Reduced Tax Reliance to Weak Governance



The first category encompasses explanations centred on the idea that access to non-tax revenue is likely to increase total government revenue, and thus contribute to entrenching governments' political authority and weakening demands for responsiveness and accountability. There are three primary variants of this argument, as states may be able to reduce pressure for political reform by expanding public spending, patronage or repression. The 'public spending effect' captures the possibility that states with abundant resource wealth may be able to expand public services and thus reduce public demands for political accountability. The 'patronage effect' is based on the possibility that states with access to

extensive natural resource revenue may be able to dispense sufficient patronage to political rivals to reduce the risk of sustained political challenges. Finally, the ‘repression effect’ captures the possibility that states with access to significant non-tax revenue may be able to invest heavily in the security apparatus in order to block pressures for political reform (Ross 2001, Morrison 2009).⁴

The second category of explanations focuses on the impact of non-tax revenue on the likelihood of destructive forms of competition for state resources. These explanations centre on the argument that the disproportionate economic importance of natural resource wealth may lead to destructive forms of political competition as competing groups seek to control the benefits of resource wealth, thus undermining the quality of governance. The more modest form of this argument can be termed the “corruption effect”, as resource wealth may open up myriad opportunities for large-scale corruption. Aside from the simple loss of public resources, the expansion of corruption is likely to draw public officials away from focusing on more productive tasks and create disincentives for reforms aimed at increasing transparency and governmental accountability. More insidiously, the scale of the resources available through corruption may shape political competition such that dispensing personal patronage through corruption becomes an unavoidable prerequisite for securing effective political support (Kolstad and Wiig 2008).

A more dramatic possibility is a “conflict effect”, as extensive natural resource wealth may generate a heightened risk of armed conflict, as armed groups compete for control over resource wealth. In simplified terms, centrally controlled resources are expected to increase the value of controlling the state, and may thus increase the likelihood that opposition groups will seek to seize control of the state by force. At the same time, geographically dispersed resource wealth may increase the risk of secessionist conflict in resource rich

⁴ The discussion in Ross (2001: 332-37), which is also summarized in Dunning (2008: 54), motivates parts of this summary. He argues that states that are more reliant on non-tax revenue are less likely to be responsive and accountable owing to a “rentier effect”, a “repression effect” and a “modernization effect”. I draw on the term “repression effect” here, while his “rentier effect” roughly encompasses what I have termed the “public spending” and “patronage” effects, as I find this finer distinction useful. I do not focus on the “modernization effect”, which he employs to capture the possibility that resource based growth will not lead to broader economic modernization, as this possibility has received comparatively little attention in the relevant literature.

areas, while providing financing for civil wars (Collier and Hoeffler 2004, 2009). Needless to say, both coups and civil wars are likely to undermine the overall quality of governance and development outcomes more generally.

Finally, the third category of explanations focuses on the potential governance consequences of a reduced need to raise tax revenue. These arguments follow the broad logic that the need for states to raise tax revenue from their citizens may create positive incentives for improved governance, while access to natural resource wealth is likely to reduce the need for such governance-enhancing taxation. In a slightly broader sense, these explanations can be usefully thought of as focusing on the positive political implications of reliance of taxation, whereas the preceding explanations are focused on the directly negative implications of access to non-tax revenue.

While explanations within this third category all focus on the positive governance incentives that may be generated by the need for taxation, there are at least three distinct ways in which greater taxation may contribute to improved governance. The first possibility is a “state capacity effect”, as the need for taxation may create pressure for the strengthening of the state apparatus. Collecting taxes requires the development of a complex and intrusive bureaucratic apparatus, which may become the leading edge of broader improvements in public administration (Brewer 1989, Tilly 1990, Chaudhry 1997, Brautigam 2008, Prichard and Leonard 2010).⁵ The second possibility is an “economic policy effect”, as tax reliance may lead governments to more actively seek to create conditions conducive to economic growth. Quite simply, governments that are reliant on tax revenue have a common interest in promoting the prosperity of taxpayers in order to maximize levels of tax revenue. As Bates (2001: 69) has written of early modern Europe, “governments pursued policies that promoted the development of the economy not because they wanted to but because they had to, the better to secure the resources with which to fight”.

⁵ This possibility has been well documented in early modern Europe (Brewer 1989, Tilly 1990), while a growing body of research has also pointed to the importance of taxation to the development of broader administrative capacity in contemporary developing countries (Chaudhry 1997, Brautigam 2008, Prichard and Leonard 2010).

Finally, the need for governments to raise tax revenue may induce a “responsiveness and accountability effect” by strengthening incentives for governments to concede responsiveness and accountability to taxpayers. It is this possibility that is the focus of this research, which, while interested in the broad relationship between tax reliance and governance outcomes, focuses on the specific possibility that the need for tax revenue may strengthen the ability of taxpayers to make demands on government. In broad terms, this possibility reflects two mechanisms. The first revolves around the potential for *tax resistance*: the ability of taxpayers to resist taxation may generate positive incentives for governments to become more responsive and accountable in order to encourage greater compliance with taxes. The second revolves around the potential for taxation to *catalyze collective action*: the experience of being taxed may lead taxpayers to take a more active interest in overseeing the use of government revenue, and thus to make collective demands for responsiveness and accountability.

Before moving on, it is worth concluding by noting that while most of the literature on this topic has emphasized the potential governance costs of reliance on natural resource wealth, a smaller number of recent studies have argued that in some cases reduced tax reliance may actually contribute to improved governance. Morrison (2009) has proposed that by increasing the ability of states to purchase political support and repress dissent, access to natural resource wealth may increase political stability, which may, in turn, carry governance benefits. Herb (2005) has argued that, alongside many of the processes noted here, access to natural resource wealth may also generate positive pressure for political liberalization by promoting a measure of economic growth. Finally, Dunning (2008) has proposed the most direct alternative to the argument being explored here, arguing that by reducing the need for taxation access to resource wealth may reduce redistributive conflict, and thus increase the likelihood that elites will embrace democracy. This thesis does not directly address these various propositions, but they are a further reminder that there are many pathways through which resource wealth may shape political outcomes, many of which may be simultaneously relevant. This research is focused on only one such pathway,

albeit one that has been particularly central to historical accounts of state building in the developed world.

1.3. Taxation, Responsiveness and Accountability

Having broadly contextualized the focus of this research, this section turns to reviewing the comparatively limited body of research that deals directly with the questions being explored by this thesis. This is necessary both in order to lay the foundation for the analysis to follow and in order to highlight the particular research contribution being made by this thesis. This section is divided into three parts. The first reviews the historical literature linking taxation to improvements in governance in early modern Europe and the United States, as this literature has motivated much of the work in this field. The second reviews the quality of the existing evidence of a relationship between taxation, responsiveness and accountability in contemporary developing countries. The third then highlights the limitations of this evidence, and the specific justification for this research.

1.3.1. Taxation and the History of State-Building

The argument being explored by this thesis has its roots in a particular reading of the history of state formation in early modern Europe and the United States, which holds that the need for taxation brought governments into conflict with taxpayers and ultimately contributed to the expansion of responsiveness and accountability. This often resulted from explicit or implicit ‘tax bargains’ that saw taxpayers agree to comply with new taxes in exchange for the extension of governmental accountability, through the expansion of representation, the strengthening of the rule of law and the protection of private property rights (Tilly 1990, North and Weingast 1989). In simplest terms, the need for taxation became a catalyst for profound changes in the way that states were governed. This stylized narrative captures important similarities across a range of historical cases, but also disguises significant differences, even among the small number of cases that are commonly held up as exemplars of this relationship. What follows presents simplified sketches of the historical experiences of England, France and the United States, as these cases highlight the centrality of taxation to political change, but also reveal significant diversity in the particular causal processes at work.

The experience of 17th century England epitomizes the ideal of relatively explicit ‘tax bargaining’, as tax compliance was willingly exchanged for the expansion of accountability. By the beginning of the 17th century Britain had established an independent court system to defend the rule of law and a parliament with legal control over taxation. Yet despite the legal status of parliament and the courts, the ambitions of the monarchy and the escalating costs of war led successive kings to defy both parliament and the courts in resorting to unilateral revenue raising strategies, which included new customs charges, forced loans, the sale of monopolies, property seizures and the sale of peerages (North and Weingast 1989, Tilly 1990). Over time these abuses by the Crown contributed to growing anger among taxpayers and parliamentarians and, eventually, to civil war and the overthrow of the monarchy in 1641. The decision to re-install the monarchy in 1660 was only taken on the condition that it “confirmed the power of Parliament within the British state, especially when it came to revenues and expenditures” (Tilly 1990: 157).

Despite this apparent agreement, it was not long before conflicts between parliament and the monarchy re-emerged, thus contributing to a second overthrow of the Crown in 1688, dubbed the Glorious Revolution. That same year parliament elected to offer the Crown to the future King William, but did so only after a further institutional revolution, which strengthened the position of parliament and the courts, and shifted the locus of effective power away from the monarchy. This represented a classic tax bargain, as taxpayers agreed to accept increased tax collection in exchange for the institutionalized expansion of governmental accountability. This tax bargain, in turn, figured centrally in the flourishing of the British state, as it facilitated an increase in the level and stability of tax revenue, a correspondingly increased capacity to borrow abroad and the construction of a more sophisticated bureaucratic apparatus (Brewer 1989, Tilly 1990).

A century later in France the need for tax revenue to meet the escalating costs of warfare and debt repayment similarly sparked a period of political conflict that ended with the establishment of a more capable, responsive and accountable government. That said, this outcome lacked the relatively explicit ‘tax bargaining’ of the English case, and instead emerged from revolution and an extended period of political upheaval.

By the second half of the 18th Century the escalating costs of war had led the French state to the brink of bankruptcy. At the time France relied on an inefficient feudal tax system in which the clergy and nobility largely avoided taxation, while the greatest burden fell on agricultural producers and a growing bourgeoisie. Efforts to increase the share of revenue collected by the central state proved both ineffective and unpopular, and led to increasing conflict between the state and taxpayers. By 1789 the fiscal situation had become sufficiently desperate that the king was compelled to summon the Estates General, comprised of the clergy, the nobility and the more broadly representative Third Estate, in order to debate a new fiscal regime. Yet unlike in the British case, this meeting failed to yield a tax bargain in which increased revenue was exchanged for greater accountability. Instead, the summoning of the Estates General, which had not occurred since 1614, catalyzed the coalescing of a much wider array of grievances among the members of the Third Estate, who had soon declared themselves the new National Assembly.

The initial phase of the French Revolution lasted until Napoleon seized power in 1799, and yielded two new constitutions during a complex period of political upheaval and conflict. By the end of the process the feudal system of rural relations had been largely eliminated and replaced by a powerful and centralized bureaucratic state, with a much-expanded role for the emerging bourgeoisie. Moreover, while the revolutionary government was overthrown after only a decade, it nonetheless introduced the tradition of republican government and thus contributed to the long-term expansion of accountability. Thus the Revolution, which was precipitated by a fiscal crisis, gave rise to dramatic political changes. However, the path from tax conflict to political change did not rely on bargaining in the relatively explicit sense of English experience. Instead it was persistent and unresolved resistance to taxation that precipitated a national crisis and generated pressure for dramatic change through a long, complex and often violent process (Tilly 1990).

A final, and again dramatically different, example emerges from the role of taxation in the genesis of the American Revolution, which gave rise to the oft-quoted revolutionary slogan “no taxation without representation”. Throughout the latter half of the 18th century there

had been a debate in the American colony over whether the British parliament had the right to impose taxes. The Americans and their allies argued that under British law they could only be taxed by their own representatives. During the 1760s this objection led to the repeal of various taxes, including the stamp tax, but the British maintained a tax on tea. This was both a symbolic assertion of power and a means to raise revenue to pay the salaries of various colonial officials, in order to reaffirm their loyalty to Britain. In 1773 the issue came to a head when the British government passed the Tea Act to strengthen the legal standing of the tax on tea. This prompted the so-called Boston Tea Party during which protesters not only refused to allow a shipload of taxed tea to be unloaded, but also destroyed it by throwing it overboard. While this episode was of relatively modest practical importance it became a symbolic flashpoint for the independence movement, as it highlighted questions about the autonomy and rights of the colony and became a catalyst for popular mobilization.

Once again conflict over taxation was an essential component of the eventual expansion of responsive and accountable government, achieved though revolution, but in a manner unlike that which prevailed in either England or France. The process in Britain relied on an explicit tax bargain between taxpayers and the government in the face of a fiscal crisis, while the process in France saw resistance to taxation precipitate a fiscal crisis that opened the door to dramatic and tumultuous political changes. By contrast, the tax conflict that helped spark the American Revolution did not spring primarily from fiscal crisis, but instead revealed the ability of debates about taxation to catalyze political action around broader political grievances (Bailyn 1967, Morgan and Morgan 1953, Adams 1998).

These cases are remarkable in that they all point unambiguously to the centrality of taxation to generating pressure for responsive and accountable government, but they also represent three related, but ultimately profoundly different, causal pathways linking taxation to political change. It is this combination – a compelling argument for the centrality of taxation to political change and a striking diversity of potential causal processes and outcomes – that is a central justification for this research project.

1.3.2. Contemporary Research

These historical narratives provide substantial evidence that the need for states to raise taxes was an important driver of expanded responsiveness and accountability in early modern Europe and the United States. This historical literature has, in turn, contributed to the emergence of a small, but rich, theoretical literature detailing the possible connections between taxation, responsiveness and accountability in contemporary developing countries. Within the rational choice tradition, Margaret Levi (1988) has proposed perhaps the best-known model, which captures the logic according to which a revenue-maximizing ruler may decide to make governing concessions to taxpayers in order to encourage “quasi-voluntary compliance” with taxation. Bates and Lien (1985) have developed a similar model in which governments are expected to make governing concessions specifically in order to secure tax compliance from difficult-to-tax owners of mobile capital. More recently, Mick Moore (1998, 2007, 2008) has explored the historical literature from early modern Europe in greater depth in order to derive specific predictions about the likely implications of tax reliance for governance in contemporary developing countries.

This historical and theoretical literature provides a provocative and engaging starting point for research in this area, but it has yet to inspire the emergence of an equally persuasive body of empirical research from contemporary developing countries. Instead, contemporary empirical support for the existence of a relationship between taxation, responsiveness and accountability comes largely in the form of partial evidence from multiple different research traditions. The first source of indirect support is behavioural research that confirms the tendency of tax compliance decisions to be shaped by trust in government and satisfaction with government performance (Scholz and Lubell 1998, Torgler 2002, Feld and Frey 2002). While this behavioural research is overwhelmingly from the United States, those studies that have been carried out in developing countries have generally confirmed the basic result (Cummings et al. 2005, Alm, Sanchez and De Juan 1995, Bosco and Mittone 1997). Moreover, survey based studies from Latin America, Eastern Europe and Africa conform to this basic prediction as well (Berenson 2006, Bergman 2002, 2003, Torgler 2005, Levi and Sacks 2005), while work by Lieberman

(2002) presents a detailed account of the connections between the nature of the political community and levels of tax compliance and collection in Brazil and South Africa. While these studies do not directly test the claim that taxation has been a catalyst for the expansion of responsiveness and accountability, evidence that willingness to pay taxes is shaped by state performance is an important behavioural foundation for the broader claim.

Turning to country level research, weak governance in many resource dependent states is perhaps the most frequently cited evidence for the claim that taxation is important to the strengthening of responsiveness and accountability (Ross 2001, Herb 2005). However, while this evidence is consistent with claims about taxation and governance, it generally does not isolate the political consequences of the need to raise tax revenue from the various other ways in which access to natural resource wealth may shape political outcomes. That said, a small number of studies have focused relatively more explicitly on the implications of the absence of taxation for governance outcomes, and thus offer somewhat more persuasive evidence. Looking to history, Drelichman and Voth (2008) argue that in early modern Spain access to substantial resource wealth from the silver trade in the New World reduced the need for taxation and thus weakened institutions of accountability and contributed to political and economic decline. Turning to more contemporary cases, Chaudhry (1997) looks at the impact of non-tax revenue on the state in Saudi Arabia (oil revenue) and Yemen (remittances), and provides significant evidence that reductions in taxation contributed to the broader decay of public administration, and, consequently, the overall responsiveness of government. Crystal (1990) arrives at similar conclusions in her case studies of Kuwait and Qatar, where she argues that the merchant classes relinquished some of their political claims after the discovery of oil and the elimination of taxation. In an African context, Guyer (1992) notes the connection between expanded oil revenues and the broad weakening of local taxation and local government in Nigeria, though without providing a systematic body of empirical evidence. Overall, studies of governance in resource dependent states thus offer some support to the claim that the need for taxation can strengthen demands for responsiveness and accountability, but they generally fail to systematically focus on the importance of taxation as distinct from other possible explanations for observed outcomes.

Alternative evidence comes from several recent studies that have sought to econometrically test the argument that states that are more heavily reliant on tax revenue are more likely to be responsive and accountable. Ross (2004) finds that countries that are more heavily reliant on tax revenue, as a share of total revenue, are more likely to become more democratic in subsequent years. This result is echoed by Mahon (2005), though with significant additional caveats with respect to methodological and data challenges. Timmons (2005) provides an interesting alternative approach to the same question, looking for evidence of “fiscal contracts” in the spending patterns of different states. Consistent with his hypothesis, he reports that those taxpayer groups that pay more taxes also receive greater benefits from governments. In a variant of the resource dependence hypothesis, Brautigam and Knack (2004) consider the impact of foreign aid on tax collection and the quality of governance. They independently test the impact of foreign aid on both the quality of governance and levels of tax collection, and, finding that both relationships are negative, propose that the fall in tax collection may partially explain broader declines in the quality of governance. Finally, a pair of particularly interesting sub-national studies offer support to these cross-country findings. Gervasoni (2010) finds superior government performance in regions of Argentina in which the level of reliance on local taxation, as opposed to natural resource revenue or central government fiscal transfers, is higher. Hoffman and Gibson (2005) arrive at a similar finding in a study of regional governments in Tanzania and Zambia, as a higher share of local revenue is allocated to program budgets, as opposed to salaries, where reliance on aid and transfers is lower.

Ultimately, these studies provide valuable support for the existence of a relationship between tax reliance and governance, but they also face significant challenges that call for a degree of scepticism. At a general level, many of these studies again suffer from an inability to distinguish the specific impact of the need for taxation on governance outcomes from the broader ways in which access to non-tax revenue may shape political outcomes. That is, they are able to say little about specific causal mechanisms and processes. More importantly, there are serious questions about the robustness of the econometric results. This is particularly true of the cross-country studies, which are plagued by major problems

with the quality of available data and questions about their ability to effectively capture the relationships of interest using comparatively simple econometric models. While the results are thus indicative of the existence of a relationship, they are not entirely convincing on their own (these issues are addressed in detail in Chapter 4 of this thesis). Finally, existing sub-national studies, while not as fully subject to these risks, must nonetheless be treated with caution given the limits of available data, the difficulty of specifying a compelling causal model and the challenges inherent in measuring government performance at the sub-national level. In broad terms, while these studies are encouraging, there remains a need for significantly stronger and more nuanced evidence.

Given these limitations, case study evidence holds the potential to shed significant additional light on the research question, but in practice detailed studies have been rare. Looking to history, Brautigam (2008b) provides evidence that conflict over taxation played an important role in the institutionalization of greater domestic control over politics in Mauritius during the period of British colonial rule. In a more contemporary setting, Brand (1992) argues that a sharp reduction in foreign aid and remittances forced the Jordanian government to increase taxes, which, in turn, became a catalyst for political liberalization. In a comparison of Poland and Russia after the fall of the Soviet Union, Easter (2008) argues that the need for the Polish state to rely heavily on new taxes on income forced it to bargain with citizens and that this contributed to the emergence of more accountable government. Finally, Eubank (2010) argues that in Somaliland the absence of foreign aid forced the nascent government in the early 1990s into conflict with rival groups over major sources of tax revenue and that this contributed to a democratic bargain between the government and its rivals. All of these studies provide important support for the research hypothesis, but capture comparatively isolated examples, and thus lack either a strong comparative dimension or a robust theoretical framework.

A number of additional qualitative works touch on the topic, though without presenting systematic empirical evidence. Looking to history, Herbst (2000) has argued that the absence of broad based direct taxation in sub-Saharan Africa, owing largely to the absence of interstate conflict and the presence of foreign aid, has undermined broader processes of

state building. In a contemporary context, Chile is sometimes cited as evidence of a connection between taxation and governance because an inclusive fiscal pact, detailing the outlines of tax and expenditure policy, was central to the establishment of a broader democratic bargain during the transition from autocratic rule at the beginning of the 1990s (Bergman 2002, 2003, Weyland 1997, Boylan 1996). Yet these studies, while provocative and suggestive, do not present specific empirical evidence of the causal importance of taxation to broader governance outcomes.

Finally, while acknowledging these positive examples, it is important to note that a number of recent case studies have argued that the relevance of tax bargaining may be limited in many low-income contexts owing to the highly coercive nature of existing systems of tax collection (Fjeldstad and Semboja 2001, Fjeldstad 2001, Juul 2006, Fjeldstad and Therkildsen 2008). While these studies do not systematically explore the relationship between taxation and governance, they offer an important reminder that any such relationship is likely to be highly context specific, thus implicitly arguing for a comparative and historically grounded research strategy.

1.3.3. Establishing Causation and Understanding Context

There is thus a meaningful body of theoretical and empirical evidence that offers at least suggestive support for the argument that the need for taxation can increase pressure and incentives for the expansion of responsiveness and accountability in developing nations. However, this body of research remains incomplete. While the preceding discussion has noted the particular limitations of many of these existing studies, two more general issues appear to be particularly significant: first, the relative absence a detailed model of causation and, second, the lack of careful attention to the contextual factors that are likely to shape particular outcomes. Much of the contribution of this thesis correspondingly lies in focusing on specific causal processes, and on the contextual factors shaping those processes, and it is thus useful to briefly consider existing research addressing these issues.

1.3.3.1. The Absence of a Detailed Model of Causation

The most basic limitation of existing research lies in the absence of a sufficiently detailed model of causation. The theoretical models developed by Levi (1988) and Bates and Lien (1985) argue that the need for tax revenue strengthens incentives for governments to make concessions to taxpayers in order to secure tax compliance, and this important insight has framed much of the work in this field. Yet, there is a clear need to translate this rather general insight into an understanding of the concrete political processes through which the need for taxation is likely shape broader political outcomes. Moreover, there is a need to ask whether ‘tax bargaining’ as described in these models is the only way in which the need for taxation is likely to shape political outcomes, or whether there might also be alternative, less direct, pathways linking taxation to the expansion of responsiveness and accountability. These questions are particularly important given that existing models draw overwhelmingly on a small number of historical examples, and in doing so risk overlooking the profoundly different modern context, and the consequent likelihood of alternative causal pathways.

In addressing the likely differences between historical and contemporary experiences, Moore (2007: 16) proposes that ‘tax bargaining’, in the broad sense, is likely to comprise three elements: a) government efforts to tax citizens, b) the response of taxpayers to those efforts and c) the interaction of the two to produce specific outcomes. Building on this basic observation, he contends that, “contemporary revenue bargaining is both more diverse and, in most cases, less overt than in seventeenth century Britain” (Moore 2008: 63), relying to a much greater degree on “indirect strategic interaction and mutual behaviour adjustment without direct negotiation” (37-38). While these observations remain relatively generally, they point towards the need for detailed evidence of specific causal processes at work in contemporary settings, while also emphasizing that particular outcomes are likely to be extremely varied.

Unfortunately, existing empirical evidence largely fails to capture this expected complexity. This reflects the fact that most existing studies from the developing world have been either too isolated or too general to produce insights that are detailed but also more broadly applicable. Herbst’s (2000) work, which cites the absence of direct taxation as a long-term determinant of patterns of state building in sub-Saharan Africa, is provocative, but the

scope of the work is too broad to allow him to cite detailed country level evidence of those processes at work. Other studies, while provocative, have captured relatively isolated events, and have thus struggled to draw broader conclusions. Case studies in Mauritius (Brautigam 2008b), Jordan (Brand 1992), and Somaliland (Eubank 2010) have been focused on individual countries, and primarily on a single political episode in each country, and have thus not been in a position to comment effectively on the diversity of possible processes and outcomes or the importance of contextual factors. While several studies have taken on two-country comparisons, they too have struggled to draw more broadly relevant conclusions (Easter 2008, Bergman 2002, 2003, Crystal 1990, Chaudhry 1997).

1.3.3.2. The Importance of Context

Just as existing research says little about specific causal processes, it offers few insights into the contextual factors that are likely to make positive linkages between taxation, responsiveness and accountability more likely. This is particularly troubling given that context is absolutely central to historical accounts from early modern Europe (Tilly 1990), while there are suggestions in recent work that the highly coercive nature of taxation in much of the developing world may restrict the scope for tax bargaining (Moore 2008, Fjeldstad and Therkildsen 2008).

Moore (2008: 51) has done the most in recent years to generate concrete predictions about the importance of context to the likelihood of successful tax bargaining. He proposes that tax bargaining is most likely when a) governments have long time horizons, limited access to non-tax revenues and pressing revenue needs, b) citizens enjoy “many of the conditions conducive to collective action”, including shared interests and an understanding of the tax system, and, c) the state is sufficiently well established and effective to provide incentives for citizens to engage with government. He goes on to suggest that, consistent with limited case study evidence, coercive taxation is particularly likely at the local government level, where incomes are limited, tax systems are complex and poorly regulated, and the state is frequently weak and poorly institutionalized (44).

Unfortunately, while these predictions are theoretically compelling they are only supported by a very limited body of contemporary empirical evidence. In fact, these predictions draw attention to several aspects of the sub-Saharan African context that might be expected to weaken any potential connection between taxation, responsiveness and accountability. The first, and most obvious, issue is that countries in the region are disproportionately poor and agrarian, and these are precisely the conditions that are expected to discourage tax bargaining. Second, almost all countries in the region are heavily reliant on non-tax revenue. A large number of countries have access to large natural resource rents, including several countries with budgets dominated by oil revenues, while remaining countries almost all receive high levels of foreign aid. Thus, this thesis is exploring the importance of tax reliance and tax bargaining in a region that is generally relatively weakly reliant on tax revenue (Moore 2008).

Third, the history of taxation in the region has been characterized by conflict and illegitimacy, as tax systems in the region are overwhelmingly modelled on their colonial antecedents (Young 1986, Mamdani 1996). Prior to the arrival of colonial rule predominant forms of taxation were very different, operating as an overlapping system of tribute payments and trade taxes within a state system that lacked well defined borders (Herbst 2000). The arrival of the 'modern' colonial tax systems that remain in place today was both externally driven and highly coercive, representing a major break with earlier practices. As much as raising revenue, taxation was about "the recognition of allegiance and...inculcation of habits of work" (Pim 1948: 232, quoted in Guyer 1992: 43), and thus not surprisingly was met with hostility and derision amongst the local population. This led to periodic tax revolts and, in some cases, to tax resistance becoming intertwined with broader independence movements (Guyer 1992, Nyangira 1987, Simensen 1974, Bush and Maltby 2004). While poorly documented, there is evidence that this history has continued to shape perceptions of taxation, particularly at the local level, where poll taxes, the hallmark of colonial taxation, have been a lightning rod for controversy (Guyer 1992, Fjeldstad and Therkildsen 2008). Thus, the historically coercive nature of taxation in the region, and the lack of trust that has accompanied that history, seems likely to act as a further hurdle to tax bargaining.

Finally, tax bargaining assumes that citizens have strong incentives to bargain with an integral state, but the reality in many African nations is very different. For one, tax collection, particularly at the local level, is often fragmented, with multiple government bodies, and sometimes non-governmental entities as well, involved in collecting taxes and levies from citizens (Iversen et al. 2006, Fjeldstad, Katera and Ngalewa 2009). In such circumstances citizens are likely to lack both the ability, and the inclination, to bargain constructively with the state. There is also evidence that, again particularly at the local level, citizens frequently contribute more to voluntary community projects and organizations than they pay in taxes. This suggests that rather than bargaining with the state over taxation, citizens often prefer to circumvent it by supporting community self-help projects, religious organizations and similar efforts (Guyer 1992, Chazan 1988, Barkan and Chege 1989). In both cases the broad message is that tax evasion and avoidance may be more attractive to citizens than tax bargaining (Juul 2006). Collectively these stylized observations highlight the importance of context to the likelihood of tax bargaining and suggest that for a combination of social, economic, political and historical reasons conditions in sub-Saharan Africa may present significant barriers to taxation emerging as a catalyst for the expansion of responsiveness and accountability. This provides an important impetus to both the research focus and research methodology adopted in this thesis.

1.4. The Research Agenda: Methodology, Scope and Limitations

The research agenda that has been defined so far is relatively broad and ambitious. The thesis has three goals: first, to ask whether there is evidence that the need for governments in Ghana, Kenya and Ethiopia to tax their citizens has contributed significantly to the expansion of responsiveness and accountability by strengthening the ability of taxpayers to make political demands on government; second, to develop a more complete model of causality through which to understand this relationship, and; third, to understand the key contextual factors that have shaped particular outcomes. While it is tempting to pursue a more narrowly focused research agenda, the limited state of existing empirical research argues strongly for a relatively broad, exploratory, study of the major causal processes at

work. This study can, in turn, help to frame more focused studies in the future. The breadth of the research agenda implies the need to: put in place a careful and robust research methodology, carefully define the scope of the project and transparently acknowledge the consequent limitations of the research. While each of these issues is addressed more fully over the course of the thesis, what follows provides an overview of the most important issues.

1.4.1. Methodology

The basic methodological challenge faced by this study is straightforward: the claim that the need for taxation increases the ability of taxpayers to make successful demands for responsiveness and accountability implicitly rests on the assumption that if there was less taxation taxpayers would be less able to successfully make such demands. Unfortunately, that counterfactual is impossible to observe. The conventional solution to such problems is to rely on cross-country econometric tests. This approach makes it possible to ask, all else being equal, whether states that are more tax reliant are more responsive and accountable and whether individual states become more responsive and accountable when they become more tax reliant.

In principle, adopting an econometric approach is thus very methodologically appealing, and this research correspondingly adopts such an approach in chapter 4. Unfortunately, in practice this approach faces three major limitations. The first is conceptual, as such an approach does not allow for distinguishing between alternative explanations for the econometric results. As has already been noted, it may be that more tax reliant states are more responsive and accountable due to pressures resulting from the need to raise tax revenue, but it is equally possible that such an empirical pattern may reflect the direct political consequences of access to significant non-tax revenue. These two alternative possibilities are related, but ultimately distinct. The second limitation is pragmatic, as cross-country econometric studies are largely unable to provide a detailed picture of the specific causal processes at work or of the contextual variables that shape outcomes. Yet such information is essential to translating broad conclusions into concrete messages for policy and practice. The third limitation is econometric, as there are major challenges in

establishing the existence of a *causal* relationship between tax reliance and accountability at even a quite general level. Cross-country data indicates that countries that are more reliant on taxation are, indeed, more likely to be responsive and accountable, but this correlation alone is insufficient to establish that tax reliance is the *cause* of greater responsiveness and accountability. Tax reliance may motivate the expansion of responsiveness and accountability, but it may equally be that more responsive and accountable governments are simply more able, or inclined, to raise tax revenue. To date researchers have been unable to persuasively untangle these two competing possibilities.

While econometric analysis thus remains a valuable starting point, these limitations point to the need for case study evidence that can capture the details of political processes linking tax reliance to broader governance outcomes. Following this logic, the larger part of this research is based on detailed case study evidence from Ghana, Kenya and Ethiopia. In broad terms, the case studies ask whether there is evidence that the reliance of governments on taxation has strengthened the ability of taxpayers to implicitly and explicitly make demands for responsiveness and accountability. The analysis focuses particularly on whether changes in, and conflicts over, taxation have observably contributed to broader changes in responsiveness and accountability.

The case studies each cover extended historical periods, owing both to the suspicion that processes of tax bargaining may occur over long periods and the desire to increase the number of discrete tax episodes to be studied in each country. Despite their obvious appeal, the case studies confront a basic challenge, which has been ably summarized by Moore (2008: 38): “To the extent that revenue bargaining is indirect, taking the form of strategic interaction and mutual behaviour adjustment, rather than public haggling and agreements, how do we know it is taking place? Like some other types of political action, this one is not always easily observable.”

The thesis responds to this challenge in two ways. First, chapter 2 lays out a detailed causal model and theoretical framework, which identifies particular *observable causal processes* that are expected to link the need for taxation to the expansion of responsiveness and

accountability. While this model may not capture every process through which taxation may shape levels of responsiveness and accountability, it translates a comparatively vague research question into a set of observable possibilities. Second, the case study methodology is targeted specifically at the need to capture relatively complex and variable political processes. In simplified terms, the case studies are based on constructing analytical narratives of the history and politics of taxation, with a focus on understanding the motivations and actions of those most directly involved in tax debates and controversies. From these narratives it has then been possible to discern whether or not specific political outcomes have been motivated by tax concerns.

The primary challenge in implementing this strategy has been the absence of existing research dealing with the political economy of taxation in sub-Saharan Africa, which is consistent with the more general absence of academic attention to tax issues in the region. The absence of evidence from secondary sources has necessitated a heavy reliance on primary field research, which included eleven months of continuous field research across the three countries over the course of 2008, as well as subsequent trips to Kenya and Ghana in 2009. Along with gathering documentary evidence and tax data, the research relied heavily on interviews with key stakeholder, drawn primarily from among former and current politicians, civil servants and leading members of civil society. This included 120 formal interviews, generally lasting between one and two hours, as well as a wide array of more informal conversations and meetings with stakeholders. Interviews with long serving members of the civil service were frequently of particular importance in reconstructing the historical record, and identifying key developments and political controversies. The interviews were all semi-structured, with interviewees first asked to identify the most important tax episodes with which they had been involved and to describe the politics surrounding these episodes in their own terms. In order guard against the answers being shaped by preconceived assumptions, it was only after interviewees had described key tax episode in their own terms that further questions were posed in order to gain a deeper understanding of specific issues that were raised.

1.4.2. Scope

The decision to adopt a three-country comparative study reflects the breadth of the research question itself, the absence of existing empirical research and the value of comparison in generating new insights. There has been a consequent need for case selection criteria capable of limiting the scope sufficiently to make the research manageable while also offering sufficient variation to make the findings more broadly relevant. The case selection methodology is taken up in greater detail in chapter 5, but is briefly introduced here.

An initial decision was taken to focus on central and regional government taxation rather than local government taxation. This reflects the simple fact that in sub-Saharan Africa, more than any other region in the world, national and regional taxes comprise the overwhelming majority of revenue. While available data is of a very poor quality, it appears safe to say that local government tax collection generally comprises less than 5% of total tax revenue, and sometimes significantly less (Bird and Vaillancourt 1998, Mogues, Benin and Cudjoe 2009). While there are undoubtedly important reasons for studying local government taxation, led by the fact that the majority of low-income citizens are most directly affected by such taxes, there is a strong case for first looking at the national picture, and the bulk of tax revenue.

Beyond this basic distinction, the selection of Ghana, Kenya and Ethiopia has been motivated by four primary factors, which combine theoretical and practical considerations. First, the research is focused on countries that have experienced at least moderate levels of tax collection since the end of colonial rule. The most important consequence of this decision is that the research does not look at the experience of highly resource dependent states. This decision reflects the fact that the research methodology is based on attempting to observe the positive role of taxation in shaping political outcomes, particularly during periods of change in, and conflict over, taxation. Where levels of tax collection are extremely low there are likely to be few opportunities to observe the impact of taxation on politics.

Second, the research is focused on countries that have experienced significant changes in tax collection over time. This again reflects practical considerations, as periods during which there have been significant changes in taxation appear more likely to yield insights into the broader political relevance of taxation. While taxation may be equally likely to shape political outcomes in countries where tax collection has been extremely stable over time, that impact is less likely to be *observable* due to the absence of periods of change. Such periods of change make it possible to observe the political priorities and motivations of competing groups, as well as the particular political outcomes resulting from conflicts over taxation or changes in levels of tax collection.

Third, case selection has been aimed at selecting countries in which both levels of aid dependence and the apparent relationship between aid and taxation vary. This reflects recent scholarship arguing that aid dependence may reduce incentives for domestic tax collection, and thus reduce the scope for taxation and tax bargaining to spur broader governance gains. More generally, aid donors have played a prominent role in shaping both taxation and political incentives more generally in much of Africa, raising the possibility that political dynamics surrounding taxation may differ markedly where aid plays a large role. Across the three case study countries, aid dependence is relatively low in Kenya, moderate in Ghana and high in Ethiopia. Meanwhile macroeconomic data suggests that aid may have discouraged tax collection in Ethiopia, and possibly Kenya as well, while precisely the opposite appears to have been true in Ghana.

Finally, case selection has been aimed at maximizing remaining variation along political and economic variables, as historical evidence suggests that these variables are likely to have powerful implications for the nature of links between taxation, responsiveness and accountability. In this effort to maximize diversity three issues have been given priority: the extent of political representation, the level of economic development and the socio-historical context for taxation. With respect to political representation, Ethiopia has long been a very closed political environment, Kenya has been among the more consistently democratic countries in the region since independence and Ghana underwent a dramatic transition from military to democratic rule in the early 1990s. Turning to levels of

economic development we see a similar pattern, as Ethiopia is among the poorest countries in the world, Kenya has been among the most consistently successful economies in the region and Ghana has experienced impressive economic gains since the early 1980s following a period of acute economic crisis. Finally, the three cases offer diverse histories of taxation, as Ethiopia is unique in having never experienced full-fledged colonial rule, while taxation in Kenya has been shaped by the legacy of being a settler colony, and particularly by the prominent economic role of White and Asian controlled businesses. Given the exploratory nature of this research, this variation is extremely valuable, as it increases the likelihood of capturing both the diverse ways in which taxation may affect governance and the various contextual factors that may shape particular outcomes.

1.4.3. Limitations

These decisions about methodology and scope imply various limitations as to the conclusions and broader generalizations that can be drawn from the evidence presented here, and the two most important issues warrant acknowledgement even at this early stage.

As with any study that is heavily reliant on case study evidence, the most basic limitations relate to external validity. The case study countries have all experienced at least moderate levels of tax collection and important changes in tax collection over time. While they are reasonably representative of economic, political and historical diversity in sub-Saharan Africa, they share significant commonalities when compared to countries in other regions. There are thus inevitably questions about the relevance of these findings in other contexts. Is increased taxation likely to prompt tax bargaining in highly resource or aid dependent states, given low levels of tax reliance? Is there significant scope for tax bargaining in extremely weak states? Where states are particularly strong are governments likely to be able to rely more heavily on coercion, thus avoiding the need for tax bargaining? It is, unfortunately, impossible for a single study to cover all of these dimensions of comparison, and while this study can provide an important guide to likely processes and outcomes in these settings, research in other contexts would undoubtedly be valuable.

Second, this thesis does not aspire to address all of the many different ways in which tax reliance may shape the state, institutions and political outcomes. As has already been repeatedly noted, there are multiple pathways through which taxation may shape governance outcomes, while this thesis is focused on the specific possibility that the need for taxation may strengthen the ability of citizens to make implicit and explicit demands for responsiveness and accountability. Moreover, this thesis largely limits its empirical focus to a subset of relatively observable propositions, rather than seeking to address all of the difficult to observe ways in which taxation may shape outcomes. This is a pragmatic decision, driven by the belief that it would simply be impossible for a single study to meaningfully capture all of the ways that taxation may shape politics, along with all of the contextual factors shaping particular outcomes (Moore 2008: 49-51). There is nonetheless good reason to believe that this study is able to capture the most significant political processes and contextual factors at work, and thus provides a reasonably complete picture of the relationship of interest.

1.5. Outline of the Thesis

This introduction has presented the broad contours of the argument, and has laid out the research agenda. What remains is to outline what lies ahead.

Chapter 2 delves into the existing literature in order to develop a more nuanced and refined theoretical framework for investigating the links between tax reliance, responsiveness and accountability. It presents a detailed and observable causal model and lays out the research methodology in detail.

Chapter 3 examines the role of taxation in the broader process of state building in Ethiopia from 1855-1970, highlighting commonalities between the experience of historical Ethiopia and early modern Europe. It thus provides an empirical basis for the claim that historical processes linking taxation to broader state building outcomes are not unique to a particular historical and cultural context.

Chapter 4 begins the contemporary analysis by directly testing the relationship between tax reliance and accountability using cross-country econometric methods. It concludes that while available data is *consistent* with the research hypothesis, available data and methods are insufficient to persuasively establish a causal relationship between tax reliance and the expansion of responsiveness and accountability. This sets the stage for the case studies to follow.

Chapter 5 presents an extended discussion of case selection, while chapters 6, 7 and 8 then present the case study evidence from contemporary Ghana, Kenya and Ethiopia. Each chapter presents a detailed analytical narrative of the history and politics of taxation over at least a quarter of a century in order to clearly capture connections between taxation, responsiveness and accountability, as well as the contextual factors that have shaped particular outcomes.

Having thus presented three largely independent case studies, chapters 9, 10 and 11 draw broader conclusions. Chapter 9 focuses on the big picture, asking whether the accumulated evidence provides support for the argument that taxation has been a catalyst for the expansion of responsiveness and accountability and, if so, what particular causal processes have driven that relationship. Chapter 10 then turns to exploring the contextual factors that have made positive linkages between taxation, responsiveness and accountability most likely. Chapter 11 concludes the substantive analysis by stepping back from the particular country narratives to consider the broad role of foreign aid in shaping the potential for taxation to drive the expansion of responsiveness and accountability. Finally, the conclusions in chapter 12 summarize what has been learned and point toward opportunities for further research.

2. Theoretical Framework and Causal Model

The argument that the need for governments to rely on taxation may contribute to the expansion of responsiveness and accountability through processes of tax bargaining is both intuitively appealing and elegant in its simplicity. Unfortunately, the sheer attractiveness of the general idea appears to have contributed to a lack of specificity in defining and empirically exploring the specific causal processes through which tax reliance may contribute to the expansion of responsiveness and accountability. Important work by Levi (1988), Moore (2008) and others has provided detailed theoretical and historical accounts of the processes that may link tax reliance to broader governance gains, but this work provides only partial guidance in developing a concrete agenda for empirically driven research.

This chapter correspondingly has two intertwined goals. The first is to present a detailed theoretical framework and model through which to understand the relationship between tax reliance and the expansion of responsiveness and accountability. The second is to translate an existing body of theoretical and historical literature into a more concrete agenda for empirical research in contemporary developing countries. In pursuing these two goals the chapter proceeds in six parts. The first section presents a detailed account of the historical model of taxation and state building that has motivated much of the work in this field. Drawing on insights from that historical model, the second section specifies the research question, distinguishing it from alternative possibilities and defining the key outcomes of interest. The third section turns to theory in order to present a detailed theoretical model of tax bargaining. Section four translates insights from that theoretical model into a concrete research agenda, presenting three specific, and observable, causal processes that are expected to link taxation to the expansion of responsiveness and accountability in contemporary developing countries. Section five takes a step back and discusses those contextual factors that are likely to vary across cases and significantly affect outcomes. Finally, section six lays out the detailed research methodology.

2.1. A Model of Taxation and State Building in Early Modern Europe

While the goal of this chapter is to present a detailed, pragmatic and forward looking research agenda relevant to contemporary developing countries, it begins by exploring the basic concepts, propositions and insights that emerge from the literature on taxation and state building in early modern Europe.

The work of Charles Tilly (1990) has provided a valuable foundation for much of the recent work in this area. In simplified form, he argues that the increasing costs of warfare forced states to extract an increasingly heavy tax burden from taxpayers, and that this process was essential to shaping the character of states and of political power. In England the need for taxation led to conflicts between taxpayers and governments, and eventually resulted in tax bargains that granted taxpayers greater representation and legal protection in exchange for higher taxes. However, this example captures only one part of a much larger continuum of potential outcomes.

Tilly argues that states differed in the extent to which they were characterized by two elements: capital and coercion. Capital-intensive states were home to powerful commercial classes that controlled access to significant and mobile economic resources. Coercion-intensive states, by contrast, were largely agrarian and lacked a large commercial class of significant influence or wealth.

In capital-intensive states the primary tax challenge was to gain access to the mobile economic resources controlled by capitalists. This was achieved by ceding institutionalized political power to capitalists, in exchange for their willingness to contribute tax revenue. Such bargaining was necessary because capitalists were otherwise able to resist taxation by force or, more simply, through tax evasion facilitated by the mobility and secrecy of their assets. The tax bargains that resulted fragmented political power and limited the need for the construction of powerful central states. This was exemplified by the city-states of Italy, where councils of merchants and capitalists governed and the central state remained weak.

By contrast, states without access to the taxation of capital tended to turn towards coercion in order to extract a small surplus from the rural poor. These states generally relied on a bargain between central states and the landowning elite, by which the central state granted land and power to elites in exchange for the ability to extract tax revenue from a peasantry that was both immobile and weak. This system of revenue mobilization was coercive and unequal but nonetheless gave rise to powerful central bureaucracies capable of extracting significant revenue. This model extended throughout much of Eastern Europe and Scandinavia, and was exemplified by experience in Russia, where an increasingly powerful central state gradually extended its coercive power over the landed nobility and the subjugated peasantry.

The most successful tax bargains, as in the English case, occurred where the relative power of capitalists and of coercive states was most balanced. The strength of capitalists provided strong incentives for the state to reach a revenue enhancing compromise, while states were strong enough to establish themselves as the central political actors. However, such inclusive tax bargains only emerged in a small number of states, under relatively ideal conditions. Other states either profited through continued and often brutal coercion, or, in myriad other cases, were wiped off the map as a result of their failure to raise revenue effectively. Even in France profound changes in the state and in the nature of government emerged not from consensual bargaining between taxpayers and governments but from fiscal crisis and the outbreak of the French Revolution.

In contrast to the comparatively straightforward example of tax bargaining in early modern England, this broader reading of historical evidence highlights the complexity and contingency of the relationship between taxation and state building. For the purposes of this research three lessons are particularly important.

First, the need for taxation had multiple consequences for state building that extended beyond the simple expansion of responsiveness and accountability. While the need for tax revenue led to tax bargains that shaped the responsiveness and accountability of governments, it also influenced the growth of the central state and the organization of

economic activity. Most evidently, the need to increase taxation promoted the growth of central state bureaucracies. In Russia, the system of rural taxation gave rise to an extensive and coercive bureaucratic state, while in France one of the most important outcomes of the French Revolution was the extension of direct rule and bureaucratic government (Tilly 1990: 139-140, 107-109). Tax bargains also reflected and shaped the organization of economic activity, as tax bargains in capital-intensive states created the conditions for continued commercial expansion, while tax bargains in Eastern Europe and Russia entrenched patterns of feudal agricultural production (North and Weingast 1989, Tilly 1990: 139-140).

Second, processes of tax bargaining were multidimensional and relatively complex. The tax bargains captured by Tilly range from the granting of expanded representation and the strengthening of the rule of law, as in England, to the many cases in which monarchs ceded local autonomy to powerful landed elites in order to secure a share of the punitive taxation imposed on a vulnerable peasantry. It was thus only particular *types* of tax bargaining that contributed directly to the expansion of responsiveness and accountability.

Finally, context played a decisive role in shaping the relationship between taxation and broader state building outcomes. Tilly's model is based on the distinction between states that were home to mobile capital and those that were not, with profound consequences for the evolution of politics and the state. Alongside this distinction Tilly further emphasizes the importance of particular types of economic resources, of pre-existing political institutions and of factors that facilitated collective political action (Moore 2008, Herb 2003).

These three insights frame the organization of the remainder of this chapter. The next section addresses the multiple potential consequences of the need for states to raise tax revenue, and carefully defines the outcomes of interest here: responsiveness and accountability. The two sections that follow address the complexity of the concept of tax bargaining and of the causal processes that are likely to link tax reliance to the expansion of

responsiveness and accountability. The remaining section then addresses those contextual factors that lie outside of the core causal model but are likely to shape particular outcomes.

2.2. Specifying the Research Question

The preceding discussion has highlighted the fact that the need for taxation historically shaped governance in multiple ways, and it is thus important to distinguish those outcomes that are of particular interest to this study. As was noted in the previous chapter, it is useful to think of the potential consequences of tax reliance in terms of three types of effects: the strengthening of the state apparatus, the promotion of economic growth and the expansion of responsiveness and accountability.

The first possibility is that tax reliance may contribute to the strengthening of the state apparatus. This reflects the fact that collecting taxes requires the development of a complex and intrusive bureaucratic apparatus, which can become the leading edge of broader improvements in public administration. This possibility has been well documented in early modern Europe (Tilly 1990, Brewer 1989), while a growing body of research has also pointed to the importance of taxation to the development of broader administrative capacity in contemporary developing countries (Brautigam 2008, Prichard and Leonard 2010, Chaudhry 1997).

A second possibility is that tax reliance may lead governments to more actively seek to provide conditions conducive to economic growth. This possibility derives from the fact that governments that are reliant on tax revenue have a common interest in promoting the prosperity of taxpayers in order to maximize levels of tax revenue. While such processes are inherently difficult to observe, Gehlbach (2008) has provided evidence from the former Soviet Union that governments there have invested heavily in promoting the success of those industries most likely to contribute tax revenue to the state. The common interest of governments in promoting the prosperity of taxpayers may result in the broader expansion of responsiveness and accountability, but only in so far as this contributes to increasing economic growth.

Finally, this research is focused on processes by which tax reliance may contribute directly to the expansion of responsiveness and accountability. Within the existing literature, such governance gains are expected to emerge from processes of implicit and explicit tax bargaining between taxpayers and governments. Taxpayers are expected to wield political leverage through their potential for collective action and their ability to resist taxation, while governments will have incentives to respond to taxpayer demands in order to enhance tax compliance, sustain state revenues and limit public resistance. Of course, while tax bargaining may result in broad based expansions of accountability, it may equally result in the granting of special privileges to a narrow elite. Levi (1988:64) has argued that in order to secure tax revenue governments may provide selective benefits (“side payments”) to large mobile taxpayers, rather than providing relatively universal benefits to larger groups of taxpayers. Such ‘narrow’ tax bargaining over selective benefits is undoubtedly of interest in principle, but it is not the focus of this research. Instead, this research is focused on ‘broad’ tax bargaining that results in more general improvements in the responsiveness and accountability of governments.

The choice of responsiveness and accountability as the outcomes of interest poses obvious risks, as both are very broad concepts, and various authors have thus chosen to focus on more specific outcomes. Some have argued for a focus on representation and democracy (Ross 2004), while others have focused on the strengthening of property rights, the rule of law and other constraints on the power of the state (North and Weingast 1989, Brautigam 2008a, Mahon 2005). However, attention to a relatively broad set of potential outcomes is justified by the fact that recent research has both highlighted a wide range of possible outcomes and convincingly argued that links between taxation and formal democracy are likely to be relatively indirect (Moore 2008, Levi 1988, 1999, Herb 2003). This has led Moore, for example, to define the outcome of interest as “institutionalized influence over public policy”, but even this focus risks being excessively narrow in focusing on changes in institutions but paying little attention to simple changes in government behaviour. While a focus on institutions may be theoretically attractive, in an empirical setting political influence is often embodied in informal institutions that are difficult to observe. As a

result, changes in government behaviour (responsiveness) are likely to sometimes be the clearest indication of the political influence exercised by taxpayers.

Having justified the focus on responsiveness and accountability there remains a need for clear definitions in order to guard against a lack of precision in the use of these concepts (Lindberg 2009). Of the two terms, responsiveness is the more straightforward and is here taken to refer broadly to the substance of government action. Manin, Przeworski and Stokes (1999: 9) propose simply that, “A government is ‘responsive’ if it adopts policies that are signalled as preferred by citizens.” Thus responsiveness captures the range of concrete actions that governments may take in order to respond to the interests and preferences of citizens, which may be expressed in both explicit and implicit ways.

The term accountability demands greater caution, as it is often used loosely to refer to the ability of one set of actors to exercise control over others in pursuit of a huge variety of outcomes. Such usage often comes to encompass both outcomes and processes and has led to ambiguity and excessive overlap between the concepts of accountability and responsiveness. Andreas Schedler (1999: 13) has written that, “accountability represents an underexplored concept whose meaning remains evasive, whose boundaries are fuzzy, and whose internal structure is confusing.” More recently, Lindberg (2009: 2) has warned of the “inherent dangers of a byzantine conceptual nightmare leading not only to stretching but to severe confusion about what the core meaning of accountability is.”

Accountability is taken here to refer broadly to *institutionalized processes* that shape government action and state-society relationships. Schedler (1999:14) provides a relatively standard and widely accepted definition of accountability: “The notion of political accountability carries two basic connotations: answerability, the obligation of public officials to inform about and to explain what they are doing; and enforcement, the capacity of accounting agencies to impose sanctions on powerholders who have violated their public duties.” Thus accountability is defined in terms of the relationship between *principles*, who demand accountability, and *agents*, who are held to account. Thus, “A is accountable to B when A is obliged to inform B about A’s (past or future) actions and decisions, to justify

them, and to suffer punishment in the case of eventual misconduct” (17). Institutions of accountability are thus those formal and informal mechanisms that provide for the dual requirements of answerability and sanction. Accountability relationships may be of three broad types: Vertical-upward, vertical-downward or horizontal (Lindberg 2009). This research is essentially concerned with vertical-downward accountability, which focuses on the ability of citizens to hold politicians and the state to account, as well as on the ability of parliaments to hold the executive to account.

Of course, there is also a question of degrees of accountability. To what extent, and in what degree of detail, are agents compelled to explain and justify their actions? Are principles able to sanction the failure to provide a justification, or also the content of the actions taken? How powerful and effective are the sanctions that are available to principles (Lindberg 2009: 28-29)? Defining and recognizing differing degrees of accountability is unavoidably complex, and fraught with a degree of imprecision. To partially address this challenge, this research distinguishes between *formal institutions* of accountability, defined by the law, and *informal institutions*, which are normalized relationships and modes of decision-making that are not formally defined by law. Most systems of accountability rely on both formal and informal elements. While formal institutions of accountability may be more or less demanding, they invariably need to be complemented by widely accepted norms of behaviour in order to be effective. It is the importance of informal accountability that accounts for wide differences in the actual degree of accountability across states with nominally similar formal institutions.

The importance of informal institutions is captured in part by Grant and Keohane (2005:31), who propose that, “Information and sanctions are necessary, but not sufficient, conditions for accountability. They presuppose norms of legitimacy that establish not only the standards by which the use of power can be judged, but also who is authorized to wield power and who is properly entitled to call the power-wielders to account.” In a broader sense, formal institutions of accountability are only likely to be effective when supported by informal norms that lead those in power to fully abide by the letter and spirit of the law.

Framing the concept of accountability in terms of processes and institutions creates a clear distinction between it and the concept of responsiveness, which is concerned with the substance of government action. This should not, however, obscure the fact that the two concepts are very closely related in practice. Responsiveness may frequently be a precursor to the creation of institutions of accountability in so far as short-term responsiveness creates pressure for the institutionalization of that behaviour. This, in turn, reflects the fact that the primary purpose of institutions of accountability is frequently to guarantee that governments will be responsive. Lindberg (2009: 36-27) writes that, “The sought after fact [of accountability] is to make agents be responsive to the wishes and interests of the principals”. But, he continues, “Responsiveness should not be understood as integral to accountability itself.”

2.3. The Logic of Tax Bargaining

We turn now to the presentation of a detailed causal model linking tax reliance to the expansion of responsiveness and accountability. This section engages this challenge at the level of theory and focuses on the broad forces that may link taxation to the expansion of responsiveness and accountability. The section that follows then shifts from the relatively abstract discussion here to a concrete model encompassing specific, and observable, causal processes through which tax reliance is likely to contribute to the expansion of responsiveness and accountability in practice.

Existing research addressing the relationship between taxation, responsiveness and accountability has generally focused on the concept of tax (or revenue) bargaining. Drawing on studies from early modern Europe, Moore (2008:36-37) provides an initial definition, proposing that tax bargaining is “the exchange of tax revenues (for the state) for institutionalised influence over public policy (for citizens).” He goes on to propose that “bargaining ranges from (a) direct and explicit haggling and agreement to (b) indirect strategic interaction and mutual behaviour adjustment without direct negotiation.”

This definition provides a valuable starting point, but is also problematic, as it frames tax bargaining as a very particular kind of political process, centred on explicit or implicit

exchange. This framing implies, intentionally or not, that tax bargaining is to some extent distinct from other political processes that contribute to the expansion of responsiveness and accountability. This tendency to see tax bargaining as a distinct kind of political process is reflected in recent work by Gehlbach (2008), which explicitly positions theories of tax bargaining as an alternative to theories of collective action as an explanation for political outcomes.

More productive is to approach the political implications of taxation within the context of broader theories of political contestation and change. As was noted in the previous chapter, much recent scholarship rests either implicitly or explicitly on a simplified model of politics in which political outcomes are the result of contestation and conflict between citizens and governing elites. Within this model, the expansion of responsiveness and accountability results when citizens are able to wield sufficient political power to demand concessions from governments. Building on the logic of this simplified model, tax reliance can be understood as contributing to the expansion of responsiveness and accountability by increasing taxpayers' bargaining power vis-à-vis governments and the state.⁶

This approach has two advantages over comparatively more narrow conceptions of tax bargaining. First, it makes it possible to capture a wide array of ways in which the need for governments to raise tax revenue may directly and indirectly strengthen the ability of taxpayers to press for the expansion of responsiveness and accountability. Second, it emphasizes the fact that conflicts over taxation are best understood not as distinct and independent political processes, but as being interwoven with a broader range of processes contributing to political change.

Ultimately, the need for governments to rely on tax revenue can be understood as increasing the political bargaining power wielded by citizens through two broad channels: First, by giving citizens the ability to control the fiscal resources available to the state

⁶ While Moore's most recent work has focused on the definition of tax bargaining noted above, his earlier work has noted the possibility of understanding tax bargaining in terms of the broader model of political conflict between citizens and governments described here. He does not, however, pursue that logic in detail (Moore 2007: 14-15).

through their ability to engage in *tax resistance*; and, second, by encouraging *public engagement and collective action* among taxpayers interested in ensuring that their tax payments are employed in their interests. What follows explores each of these possibilities in turn.

2.3.1. Potential for Tax Resistance by Taxpayers

Existing models linking taxation to the expansion of responsiveness and accountability have focused on the possibility that governments may make governing concessions in order to secure greater tax compliance. The most influential such model is that of Margaret Levi (1988), who proposes that tax compliance, and thus the ability of governments to raise revenue, depends on three factors: coercion, ideology and quasi-voluntary compliance. *Coercion* refers to the use of force to compel unwilling citizens to pay taxes, *ideology* refers to social norms and ideals that provide a normative commitment to tax compliance and *quasi-voluntary compliance* captures the fact that citizens will be more likely to comply when the government is perceived to be responsive and accountable, and when other citizens comply as well. Within this framework, governments have incentives to become more responsive and accountable in order to increase quasi-voluntary compliance, and thus tax revenue. The same logic underpins the model developed by Bates and Lien (1985). They argue that governments will be most willing to make concessions in order to secure the tax compliance of those who would otherwise be most able to engage in tax evasion and avoidance. They thus conclude that tax bargaining is most likely when taxpayers own mobile wealth, which offers greater potential for evasion.

These models focus on the incentives faced by governments, and on identifying the conditions under which governments are likely to concede greater responsiveness and accountability to taxpayers in order to secure tax compliance. The argument of these models can be summarized as follows: ‘governments that are reliant on tax revenue will have stronger incentives to expand responsiveness and accountability in order to secure increased tax compliance.’ By contrast, the model presented here approaches the question from the perspective of taxpayers, focusing on the extent to which taxpayers’ ability to resist and evade taxes allows them to increase pressure for political reform. Thus, the

model presented here proposes that ‘the reliance of governments on tax revenue increases the bargaining power wielded by taxpayers by offering them opportunities to engage in tax resistance’.

In most cases these two approaches are effectively equivalent, presenting alternative framings of the same political process. However, approaching the question from the perspective of taxpayers offers two important advantages. First, it focuses attention on the decision by taxpayers to engage in more or less aggressive tax resistance and evasion. State-centric models largely assume that taxpayers will engage in tax resistance when governments are less responsive and accountable, however, in practice, taxpayer responses to taxation are likely to be shaped by a variety of factors that warrant careful empirical attention. Second, the approach adopted here captures a potentially wider variety of outcomes. State-centric approaches capture cases in which governments choose to make concessions in order to secure tax compliance, but implicitly ignore cases in which citizens engage in tax resistance but governments refuse to make corresponding concessions. Yet, tax resistance is likely to have important political implications even when governments choose not to make corresponding concessions to citizens. The model adopted here is able to capture such cases, thus broadening our understanding of the political implications of reliance on tax revenue.

2.3.2. Public Engagement and Collective Action Among Taxpayers

While tax reliance may give taxpayers bargaining power through the potential for tax resistance, it may also encourage public engagement and collective action. This likelihood stems from the simple idea that “people take more interest in what they have to pay for and are hence more likely to be interested in ensuring that they get value for their contributions” (Bird and Vaillancourt 1998: 10-11). To be more explicit, the burden of taxation may lead groups of taxpayers to become politically organized in order to make positive demands for responsiveness and accountability. This may, in turn, lead governments to make concessions to those taxpayers in order to prevent further resistance to taxation and more broadly to quell the mobilization of citizen opposition.

While collective action is difficult and often subject to narrow benefit seeking by small groups (Olson 1965), the basic logic described here is readily apparent in historical narratives of taxation and state building (Tilly 1990). To take a single example, in France conflict over taxation did not result in explicit tax bargaining, but instead catalyzed the political mobilization of the Third Estate, and the consequent onset of Revolution. What is surprising is that the role of taxation as a catalyst for public engagement and mobilization has nonetheless received comparatively little explicit attention in the state-centric models of tax bargaining described earlier (Levi 1988, Bates and Lien 1985). Because these models have sought to understand the political consequences of tax reliance from the perspective of the state, they have focused disproportionately on the importance of government efforts to encourage tax compliance through explicit tax bargaining. While such tax bargaining is clearly important, these models have paid insufficient attention to the additional possibility that the presence of taxation may shift broader political dynamics by encouraging political action by citizens. This again speaks to the value of developing a model that focuses on the impact of the need for taxation on the political power wielded by citizens.

2.4. From Theory to Practice: Causal Processes and Outcomes

Having laid out the general logic linking taxation to the expansion of responsiveness and accountability, the next challenge is to shift from a relatively theoretical approach to defining a concrete model and practical research strategy. The central challenge in making this transition is that the impact of taxation on broader political dynamics, while relatively clear in theory, is likely to be difficult to observe in practice. Drawing on Moore's (2008:37) terminology, much tax bargaining is likely to rely on subtle "mutual behaviour adjustment" among taxpayers and governments. While large-scale tax protests are very visible, it is not difficult to imagine examples of tax bargaining that are much more hidden from view. Taxpayers may engage in quiet tax evasion, in the spirit of Scott's (1985) "weapons of the weak," and thus create subtle incentives for governments to make concessions in order to improve compliance. Taxation may likewise prompt taxpayers to become increasingly organized, and to make demands on government, but in so doing

generate general pressure for reform rather than prompting specific and observable government concessions.

Given the potential difficulty of observing these political processes, it is useful to identify a subset of clearly defined, and observable, causal processes around which to organize the empirical case study analysis. These specific causal processes are unlikely to encompass all of the ways in which taxation may shape political outcomes; instead, they reflect an effort to balance the need to capture a diverse set of outcomes against the practical constraints imposed by the difficulty of observing certain types of political processes. With this in mind, what follows divides the specific causal processes of interest into two broad categories: *direct tax bargaining* and *indirect tax bargaining*.

Following Moore (2008:37), *direct tax bargaining* is taken to refer to the exchange of tax revenues (for the state) for expanded responsiveness and accountability (for citizens). While direct tax bargaining may not take the form of explicit negotiation between taxpayers and governments, it is expected to involve a discernible element of exchange, with governments making certain concession specifically in order to curtail tax-related public mobilization and/or increase tax compliance. Thus, the concept of direct tax bargaining most closely reflects existing research and theoretical models addressing the relationship between taxation, responsiveness and accountability.

By contrast, the concept of *indirect tax bargaining* captures those processes that have generally been overlooked by standard models of tax bargaining. In simplified terms direct tax bargaining captures cases in which citizens act, either through tax resistance or collective action, and governments respond by making governing concessions. By contrast, indirect tax bargaining captures cases in which taxpayers engage in tax resistance or collective action, but governments refuse to make governing concession in return. In these cases there is little or no explicit element of exchange between taxpayers and governments, but taxpayer actions may nonetheless contribute to longer-term political changes. As is described in more detail below, tax resistance may contribute to destabilizing unpopular governments, while collective action may have long-term positive effects on levels of

organization and engagement within civil society. There are thus likely to be important political processes that do not fit the traditional definition of tax bargaining, but which nonetheless link taxation to increased pressure for the expansion of responsiveness and accountability.

We can thus define *indirect tax bargaining* as capturing processes through which tax reliance increases the political bargaining power wielded by taxpayers, resulting in indirect pressure for the expansion of responsiveness and accountability in the long-term. Some readers may disagree with the use of the term ‘tax bargaining’ here, owing to the absence of clear-cut exchange between taxpayers and governments. This terminology is nonetheless adopted here because *indirect tax bargaining relies on the same causal logic as direct tax bargaining*, namely the role of tax reliance in expanding the bargaining power of taxpayers by expanding opportunities for tax resistance and collective action. Given this commonality, there is significant value in linking these concepts explicitly.

With the distinction between direct and indirect tax bargaining thus established, what follows outlines three specific causal processes that may observably link taxation to the expansion of responsiveness and accountability. The first is simply termed *direct tax bargaining* and captures cases in which governments make relatively explicit concessions to taxpayers in order to reduce tax-related public mobilization and secure increased tax collection. The second and third causal processes are both examples of indirect tax bargaining. The first is termed *tax resistance and changes in government* and captures situations in which taxpayers aggressively and successfully resist taxation, thus contributing to changes in government and subsequent reform. The second is termed *strengthened political capabilities of taxpayers* and captures cases in which increased taxation contributes to reform by catalyzing sustained political engagement and organization among taxpayers. These three causal processes most likely do not capture the entire range of difficult to observe processes through which taxation may shape the expansion of responsiveness and accountability. What they do provide is a set of observable propositions about the relationship between taxation and broader political outcomes. They are thus a

firm basis upon which to draw conclusions about the relevance of tax bargaining to the emergence of responsive and accountable government within the case study countries.

2.4.1. Direct Tax Bargaining

Direct tax bargaining captures cases in which governments make relatively explicit concessions to taxpayers in order to secure increased tax compliance and reduce public opposition prompted by tax related concerns. In broad terms direct tax bargaining is likely to proceed in one of two ways. First, taxpayers may respond to new or existing taxation through collective action or tax resistance, prompting *subsequent* concessions from governments seeking to restore political order and tax compliance. Second, the threat of collective action or tax resistance by taxpayers may lead governments to make *pre-emptive concessions* to taxpayers in order to prevent future conflict when taxation is increased. In both cases it is the reality or threat of conflict over taxation that drives change.

In cases of direct tax bargaining it should be possible to observe (a) government efforts to tax, (b) taxpayer responses and (c) their interaction and subsequent outcomes. The outcomes of interest are responsiveness and accountability, but in an empirical setting it is useful to focus on a subset of more specific outcomes that are captured by these broad concepts. Thus three particular types of outcomes are defined below: improved provision of public services, changes in tax policy and administration and broad expansions of accountability.

2.4.1.1. Improved Provision of Public Services

The government may provide improved public services to citizens in order to secure acceptance of, or compliance with, taxation. This focus on public services follows the work of Timmons (2005), Fjeldstad and Semboja (2001) and others who have argued that popular demands are often aimed narrowly at the provision of public services (responsiveness), rather than at the fundamental reform of institutions of accountability. This reflects the fact that public services including health, education, water and electricity are highly visible and among the most basic necessities for the majority of citizens in developing countries.

These outcomes can be further distinguished by the extent to which improvements in public service provision are persistent and institutionalized. At one end of this spectrum lie cases in which governments provide one-time improvements in the provision of public services, but in which these gains are neither institutionalized nor sustained over time. At the opposite end of the spectrum are cases in which governments not only increase the quality of public services, but also institutionalize those changes, through such things as oversight committees, boards of directors or legislation to enforce funding commitments. These latter cases constitute not only the expansion of responsiveness, but also a broader element of accountability. In practice, most cases are likely to lie somewhere in the middle, and analysis needs to pay attention to the persistence and institutionalization of any outcomes.

2.4.1.2. Changes in Tax Policy and Administration

An alternative possibility is that in order to secure acceptance of taxation the government may reform the tax system itself by increasing transparency, equity and consultation in tax policy and administration. This might entail simple improvements in administrative performance or changes in the distribution of the tax burden, both of which are broadly consistent with the concept of responsiveness. Alternatively, the government may expand institutionalized accountability around taxation through, for example, the elimination of discretionary tax policies, increased transparency or the creation of dedicated tax tribunals, consultative bodies or oversight committees.

While such changes are relatively narrow in their scope, they are nonetheless potentially significant. First, more equitable and transparent tax policy and administration may have large revenue and welfare implications, as new taxpayers are brought into the tax net, thus increasing public revenue and reducing the burden on existing taxpayers. Second, improvements in the performance of tax administration may become a catalyst for broader administrative gains across government, with the potential to thus improve government performance (Brautigam 2008, Chaudhry 1997, Prichard and Leonard 2010). Finally, and perhaps most importantly, greater consultation and transparency around taxation may expand public access to information on public spending and enhance expectations of reciprocity, thus encouraging long-term public engagement and broader demands on government.

2.4.1.3. Broad Expansions of Accountability

Finally, the government may institute broad-based expansions of political accountability in order to improve acceptance of, and compliance with, taxation. These outcomes most closely mirror the outcomes that emerge from the historical literature on this topic, as they represent fundamental changes in the broad rules of the game. It is useful to distinguish specific categories of outcomes, all of which may be more or less formal or informal: first, *the creation of new institutions of accountability*; second, *the strengthening of existing institutions of accountability*, and; third, *the strengthening of the rule of law and of private property rights* which, while not institutions of accountability as such, restrict the arbitrary power of government and are likely to provide a valuable foundation for future accountability (Mahon 2005, North and Weingast 1989, Brautigam 2002).

2.4.2. Tax Resistance and Changes in Government

Confronted with the threat of taxation, taxpayers have three general options: accept the new taxes, engage in collective action to demand reciprocal concessions from government or resist the new taxes. Collective action, while attractive in principle, is difficult to achieve, may involve significant risks for those involved and may be unattractive if taxpayers do not trust the ability of government to provide reciprocal benefits (Olson 1965). As such, the most common response to taxation is simple resistance and evasion. In terms of the classic decision between exit, voice and loyalty (Hirschman 1970), simple exit may frequently be preferable to, or more feasible than, the exercise of political voice.

In some cases tax resistance alone may lead to direct tax bargaining, as governments makes concessions in order to reduce resistance to taxation. But what of cases in which tax resistance does not prompt explicit concessions from government, but simply results in reduced levels of tax revenue collection? Might tax resistance nonetheless indirectly contribute to the emergence of responsive and accountable government? It certainly appears to be possible. In stylized fashion, resistance to taxation has the potential to weaken the fiscal base of an incumbent government, create pressure for a change in government and provide positive incentives for an incoming government to make concessions in order to improve tax collection in the future. In these cases any governance

reforms that are ultimately undertaken by an incoming government do not result from a recognizable process of bargaining, but from an extended period of unresolved conflict over taxation. As importantly, in this process tax resistance does not contribute to a single, visible, outcome, but is, instead, a factor contributing to a much larger process of political change.

While this process may initially appear convoluted, it is in fact highly consistent with historical experience. In the cases of tax bargaining in 17th century England the strengthening of parliament and the rule of law came at the end of decades of armed conflict and tax resistance, as taxpayers sought to limit the fiscal capacity of the monarchy. More generally, while the image of the reformist government responding to citizen demands is attractive in the abstract, historical experience suggests that major governance changes often occur only through changes in government. The suggestion that tax resistance may contribute to changes in government, and thus to reform, is supported at the macro level by evidence that unpopular governments in Africa have often experienced declining revenue (Bates 2008), while new regimes have frequently been particularly successful in pursuing tax reform (Ascher 1989, Bates 1989).

Of course, simple tax resistance is not sufficient to ensure political change. The claim that tax resistance can be an important catalyst for the expansion of responsiveness and accountability by contributing to changes in government must rest on evidence that (a) tax resistance contributed to the change in government, (b) the change in government brought important improvements in governance and (c) fiscal issues were a meaningful priority for the new government. In practice, therefore, outcomes are likely to fall into three categories. First, cases in which tax resistance leads to a reduced revenue stalemate, but there is no change in government. Second, cases in which tax resistance contributes to a change in government, but in which the new government does not expand responsiveness or accountability. Third, cases in which tax resistance contributes to a change in government, the new government is more responsive and accountable and tax compliance subsequently improves. Outcomes that fall within this final category would offer evidence that tax

resistance has, in fact, been an important indirect catalyst for expanded responsiveness and accountability.

2.4.3. Strengthened Political Capabilities of Taxpayers

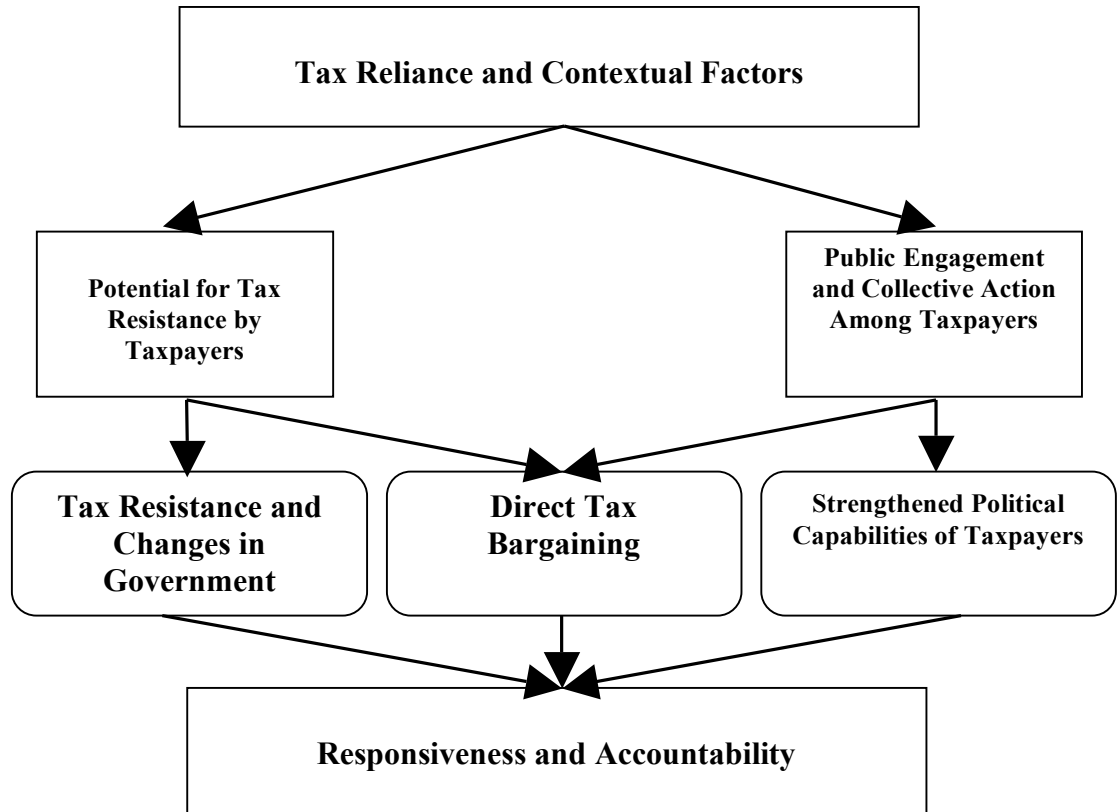
The final causal process focuses on the long-term impact of taxation on the political capabilities of taxpayers. This term is drawn from Whitehead and Gray-Molina (2003:32) who define political capabilities as, “the institutional and organizational resources as well as the collective ideas available for effective political action.”

The prediction that tax reliance will contribute to the expansion of responsiveness and accountability results to a significant degree from the possibility that taxation may lead citizens to make political demands on government. As was noted earlier, this reflects both the simple fact that taxation is unpopular and the broader expectation that when citizens are forced to pay for government they are more likely to be concerned with ensuring that they receive valued services and political influence in return. However, while taxation may encourage public engagement, achieving politically effective collective action is both challenging and potentially risky. Taxpayers may fail to coordinate effective collective action despite widespread public anger, or may succeed but then find their demands rebuffed by the government. In these cases taxpayers will have failed to secure specific concessions from governments, but these processes may nonetheless contribute to the expansion of responsiveness and accountability by enhancing the political capabilities of taxpayers in the long-term.

One way that this may happen is by altering popular expectations, with positive consequences for political engagement and collective action in the long-term. There is a long body of research arguing that norms and expectations are essential to shaping levels of political engagement, as they prescribe the demands that citizens believe that they can, and should, make on government (Goetz and Jenkins 2005, Grant and Keohane 2005, Newell and Wheeler 2006, Moehler 2008, Chazan 1983). It has equally long been believed, particularly among supporters of fiscal decentralization, that the payment of taxes may lead taxpayers to develop new expectations of government and to feel a greater sense of

ownership over government activities (Bird and Vaillancourt 1998, Juul 2006). By thus changing expectations and levels of engagement, taxation may strengthen long-term demands for responsiveness and accountability.

While the impact of taxation on norms and expectations is thus likely to be an important part of the story, these abstract concepts are difficult to observe in practice. As such this research is focused on two related, but much more concrete, ways in which taxation may strengthen the political capabilities of taxpayers. First, taxation may lead to the strengthening of civil society organizations or other relevant forms of political organization. Second, collective action in response to taxation may open up new spaces for political engagement, including the legitimization of new forms of political action and mobilization. These processes may not yield direct tax bargains in the short-term, but in the long term are likely to contribute to the expansion of responsiveness and accountability.

Figure 2.1: Tax Reliance and the Expansion of Responsiveness and Accountability

2.4.4. Tracing the Logic of the Model

Having laid out the various components of the model, it is summarized graphically in Figure 2.1. What follows traces the logic of the model from beginning to end.

The model begins with a government that is forced to rely on raising tax revenue to finance its activities. The second level of the model reflects the potential for taxpayers to respond to taxation in one of three ways: First, they may simply accept taxes without overt complaint; second, they may engage in tax resistance, either through collective political action to resist new taxes or through increasingly aggressive tax evasion and avoidance; and, third, taxation may encourage public engagement, acting as a catalyst for taxpayers to engage in broad-based collective action aimed at demanding improved responsiveness and accountability from government. The latter two possibilities may contribute to the

expansion of responsiveness and accountability, and are reflected in the two alternative branches of the model.

The third level of the model is shaped by the need for the government to decide how to respond to taxpayer actions. One option is for the government to respond to the reality or threat of tax resistance and collective action by making concessions to taxpayers in order to increase tax compliance and reduce public mobilization. In this case the result will be *direct tax bargaining* in which citizens exchange acceptance of taxation for improvements in responsiveness and accountability. The arrows in Figure 1.1 linking both tax resistance and collective action to direct tax bargaining capture this possibility.

Alternatively, the government may refuse to make concessions to taxpayers, but taxpayers' actions may nonetheless generate indirect pressure for political reform (*indirect tax bargaining*). If citizens are engaged in tax resistance, and the government refuses to make concessions, then reduced tax revenue is the most likely result. This may, in turn, weaken the overall position of the government, thus increasing the likelihood of a change in government and of subsequent governance reforms (*tax resistance and changes in government*). Similarly, if citizens engage in collective action the government may elect to respond with either indifference or active repression, thus preventing any reciprocal improvements in governance over the short-term. However, taxpayer protests, while unrequited in the short-term, may contribute to *strengthening the political capabilities of taxpayers* in the long-term, as new civil society groupings become institutionalized or heightened levels of political engagement are sustained.

This model is attractive in large part because it captures a more diverse set of possibilities than earlier models of tax bargaining. Whereas these earlier models focused largely on direct tax bargaining resulting from the threat of tax resistance, this model captures multiple causal processes reflecting differences in (a) government efforts to impose taxation, (b) taxpayer responses and (c) the interaction between those two groups. More specifically, the model includes two 'decision points' at which alternative outcomes emerge as a result of different strategic choices by taxpayers and governments.

The first ‘decision point’ surrounds the question of whether or not taxpayers respond to taxation and, if so, whether they do so primarily through tax resistance or collective action. As is discussed in greater detail below, this decision is likely to be shaped by contextual factors including initial political and economic conditions, the existing strength of civil society and particular characteristics of the tax system. The second ‘decision point’ occurs when governments decide whether to respond to taxpayer actions by making concessions, or through indifference and repression. Again, that decision is likely to be shaped by the contextual factors discussed in the next section, among which the question of *revenue pressure* is likely to be particularly important.

The term revenue pressure captures the simple idea that governments are more likely to make concessions to taxpayers when they face a more urgent need for additional revenue. By contrast, governments facing little revenue pressure are more likely to forgo concessions, counting on the fact that they can weather the challenge posed by reduced revenue or by civil society mobilization. Notably, governments that are more reliant on tax revenue (as opposed to large non-tax revenue sources) are, on average, more likely to face acute revenue pressure, and thus to be vulnerable to the need to make political concessions to taxpayers.

2.4.5. Taxation and the Absence of Tax Bargaining

Having presented the model, it is worth concluding this section with a word of caution about the interpretation of case study evidence. Even if tax bargaining is significant to long-term political outcomes there are still likely to be many cases in which individual episodes of increased taxation yield little or no evidence of direct or indirect tax bargaining. In even the best circumstances taxation remains a fundamentally coercive act, and it is often only with a longer-term view that conflicts over taxation may come to be seen as part of larger processes of bargaining and political transformation. As Ross (2004: 234) has noted, “many people dislike paying taxes, and some will cause trouble when governments raise them. But democracy is only one possible outcome of these conflicts. Historically, people have borne crushingly high tax rates with few rebellions; when they do revolt, they have

often been met with intensified repression, not democratic concessions.” The question is thus not whether there will be episodes of what are here termed *tax increases without bargaining*, as there certainly will be. Instead, the question is whether those episodes will be so frequent, or so lacking in any evidence of public engagement and mobilization, as to outweigh competing evidence of a positive relationship between taxation, responsiveness and accountability. This, of course, is a question to be answered empirically.

2.5. Contextual Factors Affecting Tax Bargaining

Within the preceding model the central importance of context is explicit, as contextual factors are expected to shape both citizen responses to taxation and the corresponding actions of governments. In some contexts taxpayers will be significantly more likely to respond to taxation through collective action, while in others reliance of quieter forms of tax resistance will be more likely. Likewise, in some contexts governments will be strongly inclined to bargain with taxpayers in order to secure tax compliance, while in others governments are likely to rely heavily on repression, thus shifting the analytical emphasis towards the possibility of more conflictual and long-term political outcomes. In more general terms, the model is based on the premise that the need for taxation can contribute to the expansion of responsiveness and accountability by altering the relative bargaining power of taxpayers and governments. As such, particular outcomes will depend to at least some extent on the myriad factors that shape the bargaining power of these competing groups.

This importance of context has received comparatively little explicit attention in recent research, but is central to Tilly’s (1990) historical account of taxation and state building in early modern Europe. In his model, it is the balance between coercion and capital in individual states that lies at the centre of the causal model, determining whether the need for taxation results in consensual tax bargaining or simply in the expansion of coercion. However, whereas Tilly’s goal was to develop an encompassing theory of state formation and state building, this study has the more modest goal of highlighting the particular importance of taxation to processes of political change. The approach to dealing with the importance of contextual factors is correspondingly also more modest. The first goal is to

provide a general analysis of the importance of broad structural factors in shaping the potential for, and character of, tax bargaining. These factors include existing political institutions, the character of economies and the many factors that shape the potential for collective action in diverse contexts. The second goal is to provide a detailed analysis of the importance of contextual factors that are relatively more specific to the issue of tax bargaining, and which are subject to policy influence, including the importance of foreign aid, tax types and tax administration.

In pursuing these goals this research draws on propositions derived from a combination of historical examples, broad theoretical arguments and a small body of existing case study research (Moore 2008: 51). The range of potentially important contextual factors is extensive and ranges from the relatively broad to the very specific, so no effort is made here to summarize all of these possibilities. Instead, this section briefly highlights six factors that existing research suggests are likely to be particularly important in shaping processes and outcomes. A more detailed discussion of contextual variables is reserved for the concluding chapters, by which point it will be possible to draw on the empirical evidence to come.

The first contextual factor of interest is the importance of *access to non-tax revenue*. This is explicit in the model, as access to non-tax revenue is expected to lead to reduced levels of taxation, and thus reduced opportunities for direct and indirect tax bargaining. Equally important are the more subtle implications of the fact that access to non-tax revenue by definition reduces the share of domestic tax collection in total government revenue. As a result, even where levels of domestic tax collection remain constant, access to significant non-tax revenue is expected to reduce the potential for taxation to become a catalyst for broader governance gains. This largely reflects the importance of revenue pressure, as governments with access to non-tax revenue will, in general, have weaker incentives to bargain with, and make concession to, taxpayers, as they are better able to tolerate reductions in tax revenue. Moreover, governments with access to substantial non-tax revenue may be less vulnerable to collective action motivated by tax concerns owing to

their capacity for repression or the use of targeted patronage to reduce opposition (the ‘public spending’, ‘patronage’ and ‘repression’ effects described in Chapter 1).

The second factor of interest is the role of foreign aid. The basic question here is whether foreign aid may reduce the likelihood of tax bargaining in much the same way as other sources of non-tax revenue (Moore 1998). The answer is far from obvious, as aid is a possible alternative to domestic taxation, but is also more politically complex than other types of non-tax revenue, as it is generally accompanied by technical assistance and external conditionality (Collier 2006). Gaining a deeper understanding of this question is of significant policy relevance but empirical research has been both limited and quite general (Brautigam and Knack 2004, Moss, Pettersson and van de Walle 2006). As a result this issue is given special attention throughout the empirical chapters to follow, and is addressed in detail in chapter 11.

The third factor is economic context, and particularly *the strength and mobility of the private sector*. In Tilly’s (1990) model economic structure and the strength of the private sector is *the* decisive determinant of whether the need for taxation will lead to the expansion of responsiveness and accountability or simply to the intensification of coercion. In his model, where there was a strong and mobile capitalist class tax bargaining was more likely, as the bargaining power of taxpayers was enhanced and the government was forced to bargain in order to secure access to those income sources. In more recent work these insights have been boiled down to the more specific prediction that where the owners of capital are highly mobile, and thus difficult to tax coercively, tax bargaining will be more likely (Bates and Lien 1985). At a more general level, a more powerful private sector and middle class is likely to enjoy a range of political resources valuable to efforts to bargain with government (Acemoglu and Robinson 2006, Moore 1966).

The fourth factor is the *nature of existing political institutions and the extent of political openness*. At the most basic level, where the existing government is firmly entrenched in power it will have few incentives to bargain with citizens, while a powerfully repressive government is likely to be able to prevent collective action and explicit demands for

responsiveness and accountability. More generally, it is almost certain that existing political institutions will shape opportunities for tax bargaining and the form that that tax bargaining takes. This notion draws on the “polity approach” popularized by Skocpol (1992:41), which “understands political activities, where carried on by politicians or by social groups, as conditioned by the institutional configuration of governments.” This broad proposition has been given specific meaning by studies of tax bargaining that have argued that institutions of representation are likely to facilitate relatively direct tax bargaining, while more conflictual and indirect forms of bargaining are likely when existing institutions are relatively weak (Levi 1988, North and Weingast 1989).

The fifth contextual factor of interest encompasses a variety of related *factors that facilitate collective political action*. While this topic has already been discussed at some length, it is useful to return to Tilly’s (1990: 101) account, where he writes that general unhappiness with taxation was likely to become “mass rebellion chiefly when (1) the state’s demands and actions offended citizens’ standards of justice or attacked their primary collective identities, (2) the people touched by offensive state actions were already connected by durable social ties, (3) ordinary people had powerful allies inside or outside the state, and (4) the state’s recent actions or interactions revealed that it was vulnerable to attack.” Similar considerations seem likely to shape outcomes in the contemporary context.

Finally, the types of processes that emerge, and their outcomes, are likely to be shaped by the *types of taxes involved, and the nature of tax administration*. While taxation has so far been treated as a single variable, in practice aggregate government tax revenue is composed of an array of taxes with vastly different characteristics. These differences can usefully be captured by considering the incidence of the tax (who is paying), the visibility of the tax (how aware taxpayers are of the tax) and the potential for tax evasion. In broadest terms, received theory suggests that tax bargaining is most likely when the visibility of taxes is high, thus making political conflict and mobilization more likely (Martin and Gabay 2007), and when the potential for evasion is high, thus giving citizens greater bargaining power (Bates and Lien 1985, Hoffman and Gibson 2005). Meanwhile, the incidence of taxes is likely to shape what groups are involved in tax bargaining, and what types of outcomes are

thus given priority (Timmons 2005). Finally, it is essential to recall that the visibility and incidence of taxes, as well as the potential for tax evasion, are likely to reflect not only formal tax laws, but also the nature and effectiveness of tax administration.

In addition to these six factors, a note is warranted about the general importance of domestic political context in shaping the types of outcomes that may emerge from tax bargaining. Any outcome, be it the expansion of public services or the creation of new institutions, is likely to be shaped by the demands of taxpayers, but also by the preferences of governments. Quite simply, governments are likely to make concessions that fit most comfortably within their overall governing strategies. Margaret Levi (1999) adopts a strong form of this argument, suggesting that “secure and relatively powerful rulers will [enter into broad tax bargain, while] insecure rulers will grant exemptions to those whose alliance is necessary to protect power” (115). A more modest conceptualization suggests that confronted with the same pressure from taxpayers different governments are likely to adopt differing responses, owing to their differing governing strategies and priorities.

2.6. Methodology

To recap, this chapter has (a) clarified the research question, (b) developed an analytical framework for understanding the relationship between taxation, responsiveness and accountability, (c) proposed a concrete set of political processes, and outcomes, that might result from increased taxation and (d) outlined a series of contextual factors that are likely to shape outcomes. Together these elements shape both the econometric tests to follow, and the organization and interpretation of the case study evidence. The final challenge, before turning to the empirical evidence itself, is to present a more detailed discussion of methodology. What follows proceeds in three sections: a broad overview of the methodological approach, a detailed presentation of the case study methodology and a consideration of limitations.

2.6.1. Mixed Methods and Case Selection

Econometric studies have recently played a prominent role in shaping understanding of the relationship between taxation, responsiveness and accountability (Ross 2004, Timmons 2005, Mahon 2005, Gervasoni 2010, Hoffman and Gibson 2005). This is unsurprising,

given that the research question is, in principle, ideally suited to cross-country comparison and the tracing of changes in revenue and governmental performance over time. On the other hand, these quantitative studies face significant methodological challenges, and have trouble identifying the particular causal processes at work or the contextual factors that shape outcomes. As a result, this research begins with econometric analysis before moving on to adopt a case study methodology that provides a more nuanced and detailed view of the processes of interest.

The specific mixed-methods strategy that is adopted here roughly follows Evan Lieberman's (2005) model of "nested-analysis." This approach calls for beginning with econometric tests of the research hypothesis, and then allowing the results of those tests to motivate subsequent case selection and methodological choices. If the econometric evidence supports the research hypothesis, then he proposes a "model-testing" analysis, which entails selecting cases that appear to fit the model in order to confirm the existence of the hypothesized causal processes. Alternatively, if the econometric evidence is inconclusive, he proposes a "model-building" approach, which implies selecting cases that are particularly likely to enhance our understanding of the relevant causal processes. While such purposeful case selection is 'biased' in the econometric sense, it is fully justified if the goal is to identify and understand underlying causal processes (Collier and Mahoney 1996).

In practice, the econometric results presented in chapter 4 are inconclusive, and the case studies thus follow a "model-building" logic. While there is significant existing evidence that is suggestive of a relationship between taxation, responsiveness and accountability, this model-building approach remains justified, and necessary, given the weakness of the econometric tests and the current absence of carefully theorized, empirically driven, case study evidence. As was described at length in the previous chapter, the basic logic of case selection has thus been to select cases that are likely to offer significant opportunities to observe the presence, or conspicuous absence, of a relationship between taxation, responsiveness and accountability. It is such cases that are expected to be most useful in illuminating the underlying causal processes at work.

2.6.2. Case Study Methodology: Episodes, Processes and Outcomes

Turning to the case studies, the major challenge lies in seeking to establish causality despite the fact that the processes involved are likely to be relatively diverse, challenging to isolate from broader political processes and generally difficult to observe. The case study methodology consequently relies on a four-part process.

First, each case study relies on the construction of an extended historical narrative of the political economy of taxation. This reliance on extended historical narratives reflects the fact that taxation is highly path dependent, and is thus best understood in historical context (Lieberman 2002, Mahon 2004, Bird and Zolt 2005, Levi 1988, Scholz and Lubell 1998, Torgler 2005). A longer narrative also holds the potential to capture a greater diversity of outcomes and to accommodate the likelihood that some processes of tax bargaining are likely to play out over multiple years or even longer.

Second, having constructed broad analytical narratives of taxation, each case study focuses on a subset of key *tax episodes*, centred on changes in levels of tax collection, tax policy or tax administration. These tax episodes ground the case study analysis, and can be usefully thought of as a subset of interconnected observations, thus expanding the number of ‘cases’ from three countries to a much larger number of tax episodes.

Third, after identifying these tax episodes the analysis traces the political interactions and outcomes that have surrounded changes in, and debates about, taxation. This approach draws on Moore’s (2007: 16) insight that, “Any realistic understanding of the processes requires that we go beyond the initial reactions to taxation of each type of actor, and take into account the ways in which they then interact, whether conflictually, cooperatively, or in more complex ways.” Thus, for each tax episode the analysis effectively answers four questions. First, what were the technical details of the change in tax collection, policy or administration? Second, what political economy factors explain the timing and details of the change? Third, how did taxpayers and/or government react to the change? And,

finally, what subsequent interactions occurred between taxpayers and government, and what were the outcomes?

Having presented this analysis, the final step has been to assess whether these narratives, surrounding individual tax episodes, constitute significant evidence of the existence of a causal relationship between taxation, responsiveness and accountability. This has been accompanied by efforts to also draw conclusions about the character of the most important causal processes involved, and about the contextual factors that have shaped outcomes across contexts. Each of the individual case studies provides partial answers, while chapters 9 and 10 evaluate the entirety of the evidence, and thus arrive at more robust conclusions.

The analytical narratives, and the conclusions that emerge from them, rely on a combination of secondary literature, primary documents and, most importantly, interviews. Reliance on interviews was dictated in part by the absence of relevant secondary literature, as even the basic history of tax collection and tax reform has been poorly documented in each of the three countries. The more important justification lies in the heavy reliance of the cases studies on *causal process observations*, which seek to capture direct evidence of intent and causality (Bennett and Elman 2006), in order to establish the existence of a causal relationship between taxation, responsiveness and accountability. The coexistence of changes in taxation and in government behaviour (correlation in econometric terms) is simply not sufficient to establish the existence of a causal relationship. It has thus been necessary to rely on the stated motivations of political actors themselves to establish that taxation was central to observed political outcomes. Thus, the majority of the causal claims in the case studies are based on explicit statements by public officials and stakeholders explaining that their actions were motivated by tax concerns, and that outcomes can be reasonably understood in those terms.

Of course, such heavy reliance on interviews involves significant risks. These risks include the possibilities that: (a) those interviewed may provide inaccurate responses in order to reflect their own interests, (b) the interviewer may lead those interviewed to provide only

confirmatory evidence, and (c) selectivity in those who are interviewed may provide an incomplete view of reality, particularly given the use of a snowballing sampling methodology. While these risks should always be borne in mind they have been minimized by interviewing diverse individuals, with conflicting political interests, and by only reporting claims that could be verified from multiple sources. Perhaps most important has been the interview methodology itself, which has been based on open ended discussions in which respondents were asked to recount broad political narratives of taxation in their own terms. Those interviewed thus had full control over the identification of key tax episodes and key political actors, with the interviewer primarily encouraging them to expand on their own narratives or asking them to comment on broad topics raised in other interviews. Finally, the results presented here have been previously shared with key informants in each of the case study countries in order to verify the general credibility of the accounts. A full list of those interviewed is presented at the end of the thesis, though there is no attribution of specific information, as promises of confidentiality were important to the willingness of informants to speak openly about potentially sensitive topics.

2.6.3. Assessing the Conclusions

Before concluding it is important to transparently acknowledge the limits and risks of this methodological approach. While there are a number of issues that could plausibly be raised, what follows focuses on two: the difficulty of observing certain processes and the need to establish a falsifiable standard of proof by which to evaluate the research findings.

The first issue is that the three specific causal processes around which the analysis is focused are unlikely to capture more subtle, and less observable, processes by which tax reliance may encourage greater responsiveness and accountability (Moore 2008: 38). Most obviously, it is likely to be difficult to observe the long-term impact of taxation on taxpayers' expectations and levels of political engagement. It is possible to observe cases in which new taxes lead to the formation of new civil society organizations, but if the experience of paying taxes subtly shifts expectations and levels of engagement over several years, or even decades, those changes will not be captured by the methodology adopted here. Similarly, it is impossible to observe the possibility that the desire to increase tax compliance may subtly encourage governments to be more responsive and accountable over

the long-term. That is, the desire to encourage tax compliance may modestly increase the likelihood that government will behave responsively and accountability in any given context. Yet, if tax considerations function at the margin of decision making they are likely to appear politically insignificant in isolation even though they may have a quietly significant impact over time. Given the difficulty of observing these processes, we are left with the likelihood that the existence of highly visible political processes may be indicative of the existence of additional, less visible, processes as well.

The second methodological concern is the need to establish a reasonable standard of proof in order to either accept or reject the claim that the need for governments to collect taxes has contributed to the expansion of responsiveness and accountability in the case study countries. Addressing this concern centres on the need to be clear about what constitutes ‘sufficient’ evidence. The argument that taxation can be a catalyst for the expansion of responsiveness and accountability is a probabilistic, rather than absolute, proposition. We do not expect that increased taxation will always lead to tax bargaining, and thus the absence of tax bargaining in some cases is not sufficient to reject the broader argument. At the same time, it is a virtual certainty that taxation will occasionally be met by public resistance, but an occasional impact is insufficient to claim that taxation is a *significant* contributor to the emergence of responsive and accountable government.

Assessing the political significance of tax bargaining is particularly difficult because it is necessary to take account of the frequency of tax bargaining, the relative importance of particular outcomes and the reality that indirect tax bargaining is likely to be impossible to observe in some cases. The only available recourse is to a subjective standard by which to judge empirical significance. The standard adopted here is the following: standard political accounts in the case study countries can be meaningfully enhanced by the inclusion of tax bargaining as an explanatory process. While a failure to meet this standard would not be decisive proof of the absence of a relationship, given the difficulty of observing some types of processes, it would certainly constitute grounds for serious scepticism. More optimistically, if the case study evidence does attain this standard of proof, there will be every reason to believe that additional, harder to observe, processes are relevant as well.

2.7. Conclusions

Over the past decade there has been growing attention to the argument that the need for developing country governments to rely on taxation may increase the likelihood that they will be responsive and accountable to their citizens. This chapter has explored this possibility in detail, arguing that this simple argument, while compelling, disguises significant complexity, which existing theoretical and empirical research has frequently failed to fully address. This chapter consequently set out to develop a detailed theoretical framework and causal model linking taxation to the expansion of responsiveness and accountability.

The causal model can be summarized as follows. The need for taxation can contribute to the expansion of responsiveness and accountability by increasing the bargaining power of taxpayers vis-à-vis the government. The need for taxation may increase the relative bargaining power of taxpayers through the potential for *tax resistance* and *collective action*. Following this basic logic, taxpayer responses to taxation may give rise to processes of direct and indirect tax bargaining that contribute to the expansion of responsiveness and accountability. This model is attractive because it identifies both the general factors that can lead to tax bargaining (tax resistance and collective action) and a specific set of observable causal processes that may directly link taxation to the expansion of responsiveness and accountability.

What remains is to apply this model in the quantitative and case study chapters to follow. This effort begins in chapter 3 with a case study of the relationship between taxation and state building in Ethiopia from 1855-1974. This chapter provides evidence that the broad processes linking taxation and state building in early modern Europe were equally relevant to the experience of early modern Ethiopia. This provides support for the contention that the processes under investigation here are not unique to the historical and cultural context of early modern Europe. Chapter 4 moves to explicitly test the relationship between tax reliance and accountability in contemporary sub-Saharan Africa using cross-country econometric tests. The results confirm that cross-country data is consistent with the existence of such a relationship. However, the chapter argues that for both technical and

conceptual reasons standard econometric models are unable to capture the complexity of the causal processes at work and thus to provide compelling evidence of a causal relationship between taxation and the expansion of responsiveness and accountability. This sets the stage for presenting the case study evidence, which generates the most important new insights. A relatively brief Chapter 5 presents the case selection methodology and important background data, while the case study evidence from Ghana, Kenya and Ethiopia is presented in chapters 6 through 8.

3. Taxation and State Building in Imperial Ethiopia

The ultimate goal of this thesis is to determine whether historical processes linking increased taxation to broader processes of state building in early modern Europe are equally relevant to understanding political development in contemporary sub-Saharan Africa. This effort involves applying a model of political development derived from the experience of early modern Europe to new, and distinct, contexts, with unique social, economic and political characteristics. In doing so, it confronts the risk that existing hypotheses about taxation and state building may be highly context specific, and only truly applicable to the particular historical and cultural context of early modern Europe and closely linked countries like the United States.

Given the potential risk of too readily applying the lessons of European history to a hugely different context, it would strengthen the analysis significantly if there were evidence of similar processes at work in historical Africa. While such evidence would not provide proof of the relevance of tax bargaining to contemporary countries in sub-Saharan Africa, it would minimally make clear that political processes linking taxation and state building are not unique to European experience. Unfortunately, for most of sub-Saharan Africa it does not make sense to even explore the question, as material and political conditions were so different as to make reasonable comparison impossible. The pre-colonial state system in most of the region had little in common with contemporary systems of nation-states. Owing in large part to low population densities, the region lacked both regular inter-state warfare and centralized bureaucratic tax systems⁷, the two key elements driving the experience of tax bargaining in early modern Europe. Adding to these fundamental differences, the development of states and politics were fundamentally shaped by the arrival of colonial rule, which saw external powers establish national boundaries and national tax systems, thus suppressing the potential for domestically driven tax bargaining (Herbst 2000).

⁷ This is not, of course, to suggest that there was no warfare in historical sub-Saharan Africa, but, rather, that warfare revolved around loosely defined empires that competed to exercise control over dispersed territories, and thus exact tribute. This stands in contrast to the European experience of reasonably well-defined borders and centralized militaries engaged in inter-states wars of conquest.

The one exception to both of these observations is Ethiopia, particularly during the modern Imperial period from 1855-1974. Ethiopia largely avoided colonial rule and had a great deal in common with historical Europe. The Ethiopian state had high population densities, reasonably well-defined borders and faced external military threats that necessitated revenue raising through increasingly bureaucratized forms of taxation. It had a highly institutionalized religion, a unique language and highly elaborated and relatively stable social hierarchies. Economically Ethiopia was reliant on intensive plough agriculture organized along recognizably feudal lines, with control over land, and agricultural surplus, dictated by established social hierarchies. Political organization correspondingly rested on large landholders exercising regional power, while granting allegiance to the Emperor in exchange for recognized privileges (Bahru Zewde 2002). Imperial Ethiopia was thus not only recognizable with respect to European experience, but particularly had much in common with the most powerful civilizations of Eastern Europe and Russia.

Given these parallels, Ethiopia presents a unique opportunity to explore the importance of taxation to broader processes of state building in a non-western context, and thus to substantiate the claim that such political processes are not unique to a particular historical or cultural context but are, instead, shaped by social, political and economic conditions. The analysis is in two parts. The first presents an extended historical narrative of the centrality of taxation to broader processes of state building in Imperial Ethiopia. The second draws on this historical narrative to propose specific conclusions. At the micro-level, the analysis highlights important episodes of conflict and compromise around taxation, consistent with the model of tax bargaining developed in the previous chapter. At the macro-level, it highlights clear parallels between the experiences of Imperial Ethiopia and early modern Europe in the broad relationship between taxation and state building over more than a century. While these findings say little about the importance of tax bargaining in contemporary sub-Saharan Africa, they provide an empirical foundation for exploring the importance of tax bargaining in a non-western context and significantly expand our understanding of the political processes involved.

3.1. State-Building and Taxation in Imperial Ethiopia

Since at least the 1st century the Ethiopian highlands have been host to conflicts between rulers with centralizing ambitions and local power holders seeking to retain their autonomy. This has given rise to powerful empires as well as to prolonged periods of uncertainty and conflict. The so-called modern period, which culminated in the formation of the Ethiopian state as it is now recognized, began in 1855 and witnessed the progressive strengthening of central state authority in conflict with the local nobility and large landowners. Throughout this period internal conflict and external threats pressed the central government to expand its authority. Taxation lay at the heart of this effort, not only because revenue was essential to the strength of the central state, but also because it became a major site of political conflict for both practical and symbolic reasons.

3.1.1. The Origins of the Modern Imperial State

Most historians trace the origins of the modern Ethiopian state to 1855 and the coming to power of Emperor Tewodoros. His rise followed a period of political fragmentation from 1769 to 1855, which came to be known as the *Zamana Masafent*, ‘the era of the Princes’. Emperor Tewodoros had methodically defeated his most powerful opponents, thus progressively centralizing power and ushering in the modern period of Imperial rule throughout the Ethiopian highlands.

Efforts by powerful leaders to unify the Ethiopian highlands were not new, but Tewodoros’ effort had gained added urgency owing to the growing external threats posed by the expanding Egyptian empire and growing European interest in the region. In the face of these external threats unification was essential, as the empire remained essentially feudal: a powerful local nobility ruled over an almost entirely rural, peasant, society and owed only relatively indirect allegiance to the Emperor. The central government lacked an established bureaucracy or administration, and still relied heavily on the personal resources of the Emperor to sustain its activities. In times of war the Emperor remained beholden to the nobility, who were called upon to mobilize both resources and troops.

The basic revenue system, which remained largely in place until the 1940s, was based on tribute payments and the provision of surplus labour by the peasantry, or *gabbar*. These tributes were paid to local landowners, who in turn provided a share of the surplus to the Emperor. Landowners themselves generally did not pay tribute on their own production and land. Given the personalized nature of these payments there was little distinction between the notions of tax and tribute, which shared a single Amharic word, *geber*.

The system of tribute was built upon a complex system of land tenure that shared broad characteristics throughout the highlands despite significant variation in the specifics. Peasants farmed most of the land, and their access to land was governed by a communal system of land rights known as *rist*. They, in turn, paid tribute to whatever noble held tributary rights to the land. *Rist-gult* and *siso-gult* were the dominant forms of tributary rights and allowed the landlord to collect tribute, of which a small share was remitted to the Emperor. *Rist-gult* derived from land grants from the Emperor, while *siso-gult* reflected traditional landholding by local rulers. *Samon* lands similarly granted tributary rights to the Orthodox Church, which was exempt from paying tribute to the central government (Bahru Zewde 2002, Schwab 1972).

Under all three forms of tenure peasants were expected to provide various forms of tribute. The first eventually came to be known as the land tax and was generally paid based on total land area and the level of cultivation of the land. The second was the tithe, or *asrat*. It was historically grounded in religion, but was also paid to landlords, and constituted ten percent of the harvest of the individual *gabbar*, which was frequently estimated from the amount of land under cultivation. The third type of tribute, which was in practice the most burdensome, was an array of feudal responsibilities towards local rulers. These included the provision of surplus labour, supporting local notables and militaries passing through the region, and the delivery of goods such as firewood and honey. The aggregate burden on the peasantry was substantial, leading to periodic resistance, and, in the 20th century, growing condemnation from Ethiopian intellectuals and political leaders (Bahru Zewde 2002).

3.1.2. Centralization and Resistance

Recognizing the relative weakness of the central government, Tewodoros gained his reputation as the first modernizing ruler of Ethiopia through his efforts to create a more centralized state, with its own financial resources and army. The creation of a strong army controlled by the central government inevitably implied a search for new revenues, and this could only be achieved by curtailing the privileges of the nobility and church by taxing their production and assets and increasing the share of tribute flowing to the central government.

In practice his aggressive efforts to achieve this goal led him into almost perpetual conflict with local rulers, and this was a recurring theme as successive Ethiopian Emperors sought to extend state power. Most problematic, and controversial, were his efforts to tax the Church, which was not only exempt from direct taxation but retained unfettered control over a huge share of the land of the Empire, traditionally estimated at one-third of the total. Tewodoros attempted to nationalize control over part of existing church lands, but this led him into an ultimately crippling conflict with the Church. Markakis (1974: 36) notes that, “Hard-pressed for funds needed to maintain his large army in the interminable campaigns he was forced to wage, he sought to curtail the privilege of tax exemption enjoyed by church lands.” Placing this conflict in larger historical context, Bahru Zewde (2002: 35) argues that, “Like all modernizing rulers, Tewodoros realized that introducing far-reaching reforms was impossible without a secure financial base. It was in an effort to solve this problem that he came into collision with the Ethiopian Orthodox Church. That ultimately proved his undoing.”

Thus, the challenge of centralizing state power, and of resisting external opposition, demanded a strong and centralized army, which in turn required the effective taxation of the Church and the landed elite. In attempting to do this Tewodoros inflamed resistance without securing the hoped for revenues. This escalating conflict lay at the heart of his defeat in 1868.

After the fall of Tewodoros, his rival Emperor Yohannes IV rose to power. Under his rule the centralizing thrust pursued by Tewodoros was more muted, as Yohannes focused much of his energy on establishing doctrinal unity within the Orthodox Church, while granting greater independence to feudal lords. According to Bahru Zewde (2002: 44),

In place of Tewodoros's head-on collision with regionalism, Yohannes followed a more cautious approach, which amounted to a conscious toleration of it. While this more realistic approach had the merit of recognizing the objective impediments to establishing a unitary state, it had the disadvantage of encouraging the latent centrifugal tendencies of the Ethiopian polity.

The one area in which Yohannes sought to exert more direct influence was in the north. Bahru Zewde (2002: 47) explains that, "while Yohannes was content to exercise only indirect control in Gojjam and Shawa, he could not afford to pursue a similar policy in the area most threatened by foreign intrusions." Thus Yohannes' rule reflects an acceptance of a limited central state, but also reinforces the fact that external threats remained a catalyst for efforts at greater centralization.

3.1.3. Emperor Menelik and the Expansion of Central Control

During the period of Yohannes's reign, the future Emperor Menelik II was building a power base in the south. His rise to power eventually reinvigorated the drive for central control, while further highlighting the primacy of the revenue imperative and of external threats in shaping the state building process.

Menelik had initially challenged Yohannes for power in the highlands, but when he was defeated he turned his attention southward. This territory, which is now southern Ethiopia, had not been a part of previous Ethiopian empires but proved to be a major source of power for Menelik, as he gained control over the fertile, coffee producing, areas in the south-west, as well as important long-distance trade posts, providing him with a powerful fiscal base. Bahru Zewde (2002:62) explains that, "the incorporation of the South-West had more than regional significance. It ensured Menelik a steady source of revenue to strengthen his

political and military position in his ultimate bid for the throne. In short, [it] made Menelik the only serious candidate for the succession to Emperor Yohannes IV.”

Menelik ultimately became Emperor in 1889, and quickly embarked on efforts to centralize authority and to establish Ethiopia's permanent borders in the face of European encroachment. The southern territories figured prominently in this effort, as Menelik sought to formalize Ethiopian claims to the new territories. In those regions that peacefully accepted Menelik's rule, he granted significant local autonomy, in exchange for regular tribute to the central government. In the majority of territories, though, he largely transplanted the feudal system of the north on to the communal land holding patterns that had previously existed in the south. He granted major landholdings to his generals and closest allies from the southern conquests, and they, in turn, inherited the right to collect tribute from the local peasantry. In this way he not only secured his control over the territory, but also the allegiance of military and political elites.

In the years that followed, Menelik continued with his centralizing agenda. This effort rested on systematically expanding his military strength while subjugating his rivals, both of which were facilitated by the growing fiscal strength of the state and the possibility of purchasing loyalty with land grants. Equally important were plans to undertake land measurement throughout the country, as a precursor to the centralization of taxation. But while Menelik enjoyed some success in the south, where conquest had weakened resistance to central initiatives, the north remained powerfully resistant to change. His final centralizing initiative was the introduction of a Ministerial system of government in 1907, apparently with the dual goals of creating greater continuity in government, and of impressing foreign interests. While the Ministerial system remained weak, and feudal relations remained dominant, Menelik's effort was a precursor to what would come later.

Throughout his rule Menelik also continued his efforts to firmly establish Ethiopia's borders, and in this he was more successful. According to Bahru Zewde (2002:61), “In April 1891, in an effort to forestall the expansion of the colonial powers from their possessions adjoining Ethiopia, he defined in a well-publicized circular to European rulers

what he considered to be the legitimate boundaries of the country.” This slowed the European advance, but did not stop an Italian invasion in 1896. The Italian invasion culminated in the battle of Adwa, at which the Ethiopians decisively defeated the colonial army. In some sense this battle exemplified Menelik’s broader agenda: successful centralization which allowed him to mobilize an effective military force armed with European weapons purchased by virtue of the growing fiscal strength of the state.

One of Menelik’s key legacies was the impact he had on economic conditions in the south. Through conquest Menelik profoundly changed land tenure in the region, replacing existing communal systems with the system of feudal holdings transplanted from the north. He followed this by instituting a process of land measurement designed to strengthen tax collection. While the system of land measurement improved tax collection, as intended, one consequence was that a growing number of peasants who were either unable or unwilling to pay those taxes were evicted from their land. This created a class of tenant farmers who were exceptionally vulnerable to the exactions of taxation, rent and tribute by landlords. This process continued throughout the decades that followed and became a stark example of the exploitative conditions that continued to prevail in rural areas (Bahru Zewde 2002: 87, Markakis 2006:154-164).

3.1.4. Emperor Haile Selassie: Modernization and Autocracy

Menelik’s reign was cut short by a series of increasingly debilitating strokes, the first of which occurred in 1906 just as his plan for a Ministerial government began to take shape. His illness and death were followed by a succession struggle that eventually brought Emperor Haile Selassie I to power. He was initially named regent in 1916, next to Empress Zewditu, and by 1930 was named Emperor after having defeated all challengers. Throughout this period he established his identity as a reformer, in that he sought to reform the traditional base of feudal power, but also as an absolutist, who gradually eliminated opponents, including all but one Minister in 1918, and built a cult of authority around himself.

Upon becoming Emperor he adopted a more aggressively modernizing agenda than his predecessors. He quickly moved to create a new constitution, motivated, like Menelik, by the need to establish a more centralized structure of government, and to cultivate a positive image with the international community. The new constitution continued the trend of vesting increasing power in a meritocratic bureaucracy, and created a bi-cameral parliament. The Emperor appointed members of the Senate, while electors drawn overwhelmingly from the landed elite elected the Chamber of Deputies.

The broad goal of the new constitution was to sharply curtail the powers of the traditional nobility. While the nobility would retain local authority, in matters of State the power of the Emperor was to be absolute. These areas included, “appointments and dismissals, the rendering of justice, the declaration and termination of wars, and the granting of land and honours” (Bahru Zewde 2002:143). The nobility was granted control of the Chamber of Deputies as a form of compromise; by formally engaging the nobility in the process lawmaking would gain greater legitimacy despite power remaining effectively with the Emperor. In the words of the author of the constitution, “we wanted to speak to the people of Ethiopia through these personalities” (quoted in Bahru Zewde 2002:143). While existing sources are not explicit on this point, it certainly appears that the Emperor decided to make this early concession in order to smooth the implementation of his modernizing agenda, in which expanded taxation figured very prominently.

By 1936 the new Emperor had fundamentally reshaped the formal institutions of government, and had established himself as the undisputed centre of power in the country. He seemed poised to take on the task of challenging the more closely guarded privileges of the nobility, among which the right to collect tribute from the *gabbar* figured prominently. But before he could embark on this effort the Italians again invaded the country from their colony in Eritrea, ultimately seizing power and forcing the Emperor into exile.

3.1.5. The Impact of the Occupation

While the Italian occupation lasted only from 1936 until 1941, it had a significant impact on the infrastructure and institutions of the country, and meaningfully altered the challenges

facing the Emperor upon his return to power. Politically, the conquest was evidence of the continued limited strength of the central government. During the Italian invasion the central government had relied on support from the regions, and the failure of some such support was pivotal to the Italian victory. Moreover, the tenuousness of regional support for the central government was further exacerbated by the conflict itself, as the Emperor's decision to go into exile cost him legitimacy in those regions that continued the resistance in his absence. This remained a source of political conflict long after the Italians had been driven out (Bahru Zewdu 1991: 209-211).

In more tangible terms, the Italian presence dramatically expanded infrastructure in the country. Most notable was the expansion of the road network, which enhanced the ability of the central government to project its power throughout the country (Gebru Tareke 1991, Eshetu Chole 1994). The expansion of the road network was accompanied by other forms of infrastructure spending, which both changed expectations in the country and demanded effective maintenance after the Italians had been driven out. Yet, just as Italian investment in infrastructure created new expectations and fiscal commitments, the new government officially abolished many taxes on the peasantry, apparently as a way of gaining popularity and out of a belief that the taxes were exploitative. This action had the desired effect, as was reflected in a common expression of peasant gratitude: "[My big brother], the Italian, with a golden belt, [is] shepherd of the poor and eats only what is his" (Gebru Tareke 1991: 192).

With the onset of World War II, the Italians were driven out of Ethiopia in 1941 by a combined force of British and Ethiopian troops. Haile Selassie was returned to the throne but this did not eliminate the European threat, posed most acutely by the British. The British had thinly veiled hopes of annexing the Muslim areas of Eritrea to Sudan, and of annexing the Ogaden, in southern Ethiopia, to their Somali territories. Moreover, they demanded enormous privileges and powers within Ethiopia in the aftermath of the victory over the Italians. Thanks to strategic diplomatic manoeuvring, and particularly a blossoming relationship with the United States, the Ethiopian government succeeded in getting the British to renounce their claims to the Ogaden in 1954, and in securing

federation with Eritrea in 1952. More generally, the Emperor gradually succeeded in weakening the special privileges granted to the British in 1941, and in re-asserting Ethiopia independence.

Ultimately, the Italian occupation had important implications for the governing strategy that Emperor Selassie would adopt upon his return to the throne. The military defeat, coupled with the legitimacy lost through his abdication, called for major investment in strengthening the military and security forces of the state. The continuing threat from the British demanded an active diplomatic policy, which in turn almost certainly depended on Selassie's efforts to project a modernizing image to the rest of the world. Finally, the infrastructure investments made by the Italians created pressure for the Emperor to expand the social role of the state. All of these new challenges required an acceleration of the project of modernization, centralization and revenue enhancement that had been initiated before the war.

3.1.6. Accelerated Reform After 1936

Confronted with the need for modernization and centralization, as well as a desire to establish total political control, Selassie embarked on a period of accelerated reform in the years immediately following his return. The first group of reforms centred on the continued transformation of the core institutions of the state in the direction of centralized bureaucratic control and military power. The second area of reform, which largely underpinned the first, was enhanced revenue mobilization.

The first reforms focused on creating an institutionalized central government. This began with a decision to re-empower government Ministers by granting them a greater role in decision-making. This was expanded by a decision in 1941 to pay all government employees a monthly salary, "thus ending the ancient system of compensating officials through granting of rights to collect and appropriate the tribute from the *gabbars*" (Markakis 1974: 152, Levine 1965: 57). The re-empowerment of the Ministers marked an attempt to create an alternative power block to the traditional nobility, while the

introduction of salaries was part of a broader effort to eliminate intermediaries in the tax collection process, thus centralizing all revenue collection.

The process of transforming feudal forms of land tenure into private land ownership, which had begun with Menelik's land measurement efforts, was also accelerated. This was aimed at minimizing feudal exactions imposed on the peasantry and at further reducing the political clout of the nobility. But while it achieved some success on both counts, it also accelerated the process of land alienation, by which peasants lost their customary land claims and were forced into exploitative tenancy agreements, particularly in the south. While it is thus debatable whether these early efforts to eliminate feudal privilege left peasants better off in a material sense, Bahru Zewde (1991: 192) concludes optimistically that, "the term *gabbar* lost its exploitative associations and assumed the more respectable connotation of taxpayer."

A third area of reform focused on the more complete centralization of the security apparatus, in response to the fragmentation that had doomed the military in the 1936 war against the Italians. This included the centralization of the army, as well as the strengthening of the police forces, and, most notably, the Imperial Bodyguard, which became the country's elite fighting force (Bahru Zewde 1991: 207-208). Finally, while it had lower priority, the period also saw a dramatic expansion of education (albeit from an exceptionally low base), and of higher education in particular. This transformation, which was meant to support the task of modernizing the central government, ultimately laid the foundation for profound political changes in the years to come.

3.1.7. The Revenue Basis of Reform

The new reform agenda was both dependent on, and intertwined with, efforts to dramatically increase central government tax collection. Additional revenue was particularly needed in order to expand the security apparatus, as budgetary allocations to the Ministries of the Interior and Defence comprised fully 35% of national expenditure in 1967, and had been even higher in previous decades. Other activities that relied on additional revenue included maintaining and expanding infrastructure built by the Italians, making

social investments in pursuit of modernization and supporting patronage networks to purchase political loyalty. As importantly, tax reform was given priority because the political challenge of reforming revenue collection was intimately tied to broader reform of the feudal structure.

The government reinstituted the pre-war tax on land in 1941, but initially did so at half of the rate that had existed before the war. This lower rate reflected the risk of popular resistance given that the Italians had previously abolished the tax. Just as important, and consistent with both political considerations and the modernizing agenda of the government, the new law abolished various feudal labour service requirements. While changes in practice were initially limited, the new law significantly improved the legal position of the peasantry relative to the pre-war period.

The government implemented a more systematic tax reform beginning in 1942. The reform established uniform rates of rural taxation based on land type, and introduced the requirement that a receipt be given for all tax payments. This latter policy was aimed at curbing abuse by tax collectors and strengthening the land claims of peasants. This reform was followed by a further proclamation in 1944, which adjusted the land tax rates, introduced a “tax in lieu of tithe” to replace the existing tithe, and abolished remaining feudal requirements on the peasantry. Finally, in 1951 the government introduced a proclamation aimed at improving tax assessment on unmeasured land in the north, as the landed elite had long prevented land measurement as a means to avoid taxation.

The government also introduced various new taxes during the period. An education tax was introduced in 1947, followed by a health tax in 1959, and both were levied on land, at rates roughly equivalent to prevailing land tax rates. The government also introduced significant new taxes on goods and services, all of which had significant implications for revenue. These taxes included an Excise Tax on Alcohol in 1943, a Motor Fuel Tax in 1948, a Salt Tax in 1954, new excise taxes on sugar, cotton yarn and textile fabrics in 1955, a Transaction Tax on imports, exports, local manufacturing and trade in 1956, and new Stamp Duties in 1957. Despite their importance to revenue these goods and services taxes

generated limited political controversy, apparently because they had a narrow incidence that was limited primarily to wealthy foreigners (Eshetu Chole 1982: 17-18).

It is impossible to precisely calculate the relative growth in tax revenue during the period due to the unavailability of GDP data prior to 1960. In the absence of data the calculations that follow assume an annual growth rate of nominal GDP of 5.5%, which is what prevailed during the decade 1960-69. Bahru Zewde (1991: 208) reports that total government revenue in 1944-45 was 38 million Birr, while a data set compiled by Wogene Yirko (1994) shows that this had grown to 66.7 million by 1950 and to 145.2 million in 1959, with over 80% of the total in both years coming from tax revenue. Assuming 5.5% nominal growth in GDP per annum from 1945-1959, central government revenue grew from 3.2% of GDP in 1945 to 6.2% of GDP in 1959. While these were extremely low levels of revenue collection in comparative perspective (Eshetu Chole 1994), this was nonetheless a prolific rate of increase in government revenue, although it had reached a plateau by the late 1950s.

Despite these increases in revenue, the application of official tax policy remained highly imperfect, and what was achieved involved significant conflict. To a large extent this conflict did not emerge from the burden of taxation as such but resulted from the broader societal transformation that underpinned these changes. As had been the case almost a century earlier, the church successfully resisted many of the changes and defended their autonomy. While the 1944 proclamation had abolished many traditional forms of tributary rights enjoyed by landowners and the church, the government issued a new proclamation in 1947 clarifying that many exactions made by the church would still be permitted.

The more general application of the new tax laws was also much less complete than had been hoped, particularly in areas in the north in which traditional forms of land tenure and authority remained strong. While these areas were not exempted from land measurement and taxation, in practice these efforts were extremely unsuccessful. The extent of this conflict was exemplified by the outbreak of the *Weyane* rebellion in the northern province of Tigray in 1943. Gebru Tareke (1991: 92) explains that, “the Italians had cancelled all levies except the tithe and of that they collected little. The re-imposition of tax, which was

publicized as a guarantee of tenure, turned out to be an unpopular act, and taxation, which was inefficiently and indiscriminately administered, was resisted by the greater part of the peasantry... The method of tax collection was as unendurable as the taxes” (92). *Weyane* was a full-scale rebellion and continues to figure prominently in popular histories of the region, and while taxation was by no means the only cause of the conflict, it figured prominently. This is reflected in the fact that one of the outcomes of the conflict was a government commitment to maintain taxation at pre-war levels, despite increases that were being implemented elsewhere.

Most importantly, even under the reformed laws landlords themselves remained largely exempt from taxation, and were simply required to remit a share of the taxes paid by the *gabbar*. Markakis (1976: 153) explains that, “According to the principles of the complex taxation system, as it existed until 1967, the landholding class was not being taxed on either its holdings or the revenue derived from them. On the contrary, the landholding class continued to appropriate part of the tax revenue, though not as large as previously. The political power of this class guaranteed its exemption from taxation.” While land tax was only one of the many components of tax revenue during the period, weak implementation was almost certainly an important factor in the stagnation of public revenue in the late 1950s.

3.1.8. Political Crisis and Decline

By the 1950s the pace of reform appeared to be slowing, but this changed abruptly in 1960 when a group of military officers staged an unsuccessful coup attempt. While the coup attempt itself was not particularly remarkable, it fundamentally changed the tone of politics, and placed major new fiscal pressures on the government. Bahru Zewde (1991: 209) explains that, “Before the coup, opposition tended to be conspiratorial and elitist; after it, opposition was more open and mass-based.” As a result of increasingly public opposition, the Emperor moved to consolidate his personal power, and continued to expand the security apparatus. Meanwhile, he came increasingly into conflict with both the landed elite and the new urban intelligentsia.

Conflict with the landed elite emanated from the Emperor's continuing efforts to centralize government power, to weaken the feudal system in the countryside and to extract greater revenue. The conflict over revenue stemmed directly from changed circumstances after the coup attempt. One of the earliest consequences of the coup attempt had been fiscal, as the Emperor made promises of significant rewards to those who had remained loyal. This included increased salaries for the military and an acceleration of land grants to his supporters. More generally, the coup had convinced the Emperor that he needed to dramatically increase government revenues and spending in order to strengthen the security apparatus, expand social services to meet growing demand and secure sufficient resources to buy political loyalty through patronage. These revenue needs implied that he would need to come directly into conflict with the landholding elite who had until then resisted the implementation of many of the government's reforms.

While the landed elite accused Selassie of being too aggressive in seeking to increase taxation and attack their traditional privileges, the growing urban intelligentsia accused him of precisely the opposite. These young intellectuals were largely the product of the government's investment in education after 1941, and were joined by a small but influential group who had been able to travel abroad for their education. Armed with an awareness of the outside world in a country that had historically remained very insular, these young intellectuals came to see the country as being tragically backward, and, after 1960, began to call publicly for modernization. No aspect of the Ethiopian situation was more offensive to this urban elite than the persistence of exploitative feudal relations in the countryside, and many of the young intelligentsia took on the language and ideas of socialism in their calls for fundamental reform.

These tensions progressively escalated, and Selassie's government was quite suddenly overthrown in 1974. Most authors trace this overthrow to the inherent contradiction of Ethiopian society: A growing urban intellectual class demanding rapid modernization juxtaposed with a countryside that remained in the grips of a feudal landowning class. These authors argue that in this context Selassie had few options, as any action was likely to be condemned from both the right and the left. Selassie's overthrow in 1974 came as a

surprise to most observers, as he had retained the appearance of total power and control while becoming a fixture in international diplomatic circles. Yet the reality was that his base of support had been progressively eroded, and his overthrow proved a relatively straightforward affair, with most of the subsequent violence erupting between rival groups claiming power (Bahru Zewde 2002). While there is clearly much more that can be said about these episodes, it is beyond the scope of this research. Instead, the following section considers the important role of conflict over taxation during this period, as taxation was both an important contributor to the process and a microcosm of broader political realities in Ethiopia after 1960.

3.1.9. Tax Conflicts and the end of Empire

Increased fiscal demands on the state after 1960 are reflected in the rapid growth of expenditure, which increased from 8.5% of GDP in 1961 to 14% in 1973. While this burden was relieved somewhat by the introduction of foreign aid in 1964, it was primarily met by the very rapid growth of tax revenue. Revenue rose from 6.5% of GDP in 1959 to 9.4% in 1966 and to 11% in 1973, and these gains cut across all major tax types.

Until 1966, revenue growth occurred in the absence of any major tax policy reforms, and reflected the increasingly assertive collection of existing taxes, along with some escalation in customs duties. The increased collection of non-agricultural taxes, despite comprising the largest share of revenue, seems to have prompted relatively little public response, presumably owing to the narrow, frequently expatriate, tax base. By contrast, increasingly assertive efforts to collect agricultural taxes spurred meaningful conflict.

The conflict caused by more aggressive tax collection was exemplified by the Bale rebellion in the south, which began in 1963. Gebru Tareke (1991) explains that conflict emerged when the aggressive implementation of the policy of land measurement led to a sharp increase in the level of tax assessments on many peasants. When a large share of the peasantry either could not, or would not, pay, the government confiscated large tracts of land and forced former residents into tenancy. The government simultaneously sought to increase tax collection from notoriously difficult to tax pastoral groups, through the Cattle

Tax and grazing fees. In so doing the government imposed increasing restrictions on the movement of pastoralists, which further fed the conflict. Coupled with additional local grievances, these tax conflicts gave rise to an extended period of armed conflict in the region.

With increasingly aggressive collection already spurring conflict, the most dramatic tax events of the period came in 1966 and 1967 with the introduction of the Land Tax (Amendment) Proclamation and the introduction of an agricultural income tax. Both taxes aimed at increasing existing tax collection, dismantling the feudal system of land tenancy and fully taxing the landed elite. This put the government on a collision course with landowners. Yet this was perceived as a necessary risk given the need for revenue in order to sustain the rule of the Emperor. As a palace official interviewed by journalist Ryszard Kapuscinski (1978: 96) put it: “Since the cost of loyalty was going up, there was an urgent need to increase income, and that’s why the Finance Ministry ordered the [new] taxes.”

The Land Tax Proclamation formally abolished *rist gult* and *siso gult* landholding, by legislating that both *gabbars* and landlords would pay tax directly to the central government based on their individual landholdings. *Gult* holding landlords would claim a certain part of that land as their personal, private, holding, while the remainder of the land would become the property of the tiller. This implied a profound change in the position of the *gabbar*, and a major step towards the abolition of feudal structures. Yet while the legislation was passed with little conflict it appears that implementation was very limited. Bahru Zewde (1991: 193), among others, argues that, “in practice, the holders of such rights, particularly of the *resta [rist] gult*, were too well entrenched and too close to the centre of power to allow the full implementation of the decree. Measures to terminate the church’s gult were not even considered.”

Given weak implementation, an agricultural income tax was proposed in 1967 in pursuit of very similar goals, as part of the Income Tax (Amendment) Proclamation. It called for the traditional tithe to be replaced by a graduated tax on agricultural income, which would apply to all sources of income, including rent, and be paid by landlords and *gabbar* alike. It

also called for the implementation of a new tax on unutilized land, which was overwhelmingly held by large landlords. Finally, in order to achieve these goals, it called for land measurement and the deployment of tax assessors throughout the country.

This new legislation quickly became the source of a major political conflict that successfully undermined many of the provisions of the law and had far-reaching political consequences. The initial conflict emerged in the Chamber of Deputies, which was dominated by large landowners with a strong interest in watering down the legislation. The previously docile Chamber forced several revisions to the bill. Most notably, tax assessment was vested in local Tax Assessment Committees rather than the Ministry of Finance, ensuring local control over assessments, while proposed taxes on unutilized land and livestock sales were eliminated.

Once the watered down legislation made it through parliament, it was plagued by the non-compliance of large landlords throughout the country, who largely refused to allow the measurement of land or the effective assessment of their incomes. Quoting Schwab (1972: 146-47): “Tax assessors dare not approach very large landholders because of their political or economic position. The Ministry of Finance, having no knowledge of the amount of land owned by these individuals, can do little to rectify the situation, and continues to lose a vast amount of revenue from such untapped sources.” Most strikingly, the landlords continued to collect the tithe, despite the fact that it had been abolished, but were now able to avoid remitting a share to the government. There is evidence, however, that the law did have some impact, though much smaller than hoped. There were noticeable increases in tax revenue, peasants came to feel a greater sense of control over their land, and the Tax Assessment Committees became an important part of the local bureaucratic infrastructure after 1967 (Schwab 1972).

The final, and most dramatic, evidence of the politicization of agricultural taxation was the emergence of armed rebellion against the tax in the north-central province of Gojjam. The rebellion began when groups of farmers refused to pay the new tax and began attacking tax collectors. Over time, the rebellion extended to include attacks on a broader range of

government buildings and officials, and came to include ever-larger sections of the province, as rebel leaders enlisted the support of neighbouring areas (Schwab 1970). The proximate explanation for the hostile reaction among peasants lay in the strength of communal forms of landholding. According to Gebru Tareke (1991: 166), “since the collective payment of land tax has traditionally been regarded as the sole evidence of ‘communal’ ownership, it was widely but erroneously believed that taxational changes were inevitably bound up with alterations in land use. To reject land measurement and tax reform was, therefore, to defend the integrity of *rist*, even though this would mean perpetuating the tributary system. What the tillers wanted to avoid was the dreadful fate of their southern counterparts.” Thus the fear of entirely losing their land claims led the peasantry, with their fears stoked by local elites, to violently oppose a tax that was intended to lessen the tributary burden.

Beyond this proximate issue, the roots of the conflict also lay in historical enmity between the region and the central government. Gojjam had long been very independent, as it was geographically isolated by large rivers and had been the site of major resistance to the Italian occupation. The Emperor had nonetheless appointed a corrupt and brutal outsider, Tsehayu Enque Selassie, as Governor in the wake of the occupation, and this incursion on local autonomy had bred enormous resentment despite the equal brutality of his local predecessor. Thus, the tax conflict became a catalyst for the outpouring of grievances against the governor and the central government, and this was reflected in the outcomes of the rebellion when it was resolved over a year later. The government made significant tax concessions, as the agricultural income tax was suspended indefinitely and the Emperor cancelled all tax arrears for the previous nineteen years. Yet the demands of the rebels were much broader, encompassing concerns including health, education, transport and the removal of unpopular public officials. Tellingly, it was a decision by the central government to remove the most unpopular public officials, including the governor, which appears to have been most crucial to calming the rebellion (Gebru Tareke 1991).

3.2. Taxation, Accountability and a Failed Fiscal Contract

The preceding narrative leaves little doubt about the importance of conflicts over taxation to the state building process in Imperial Ethiopia. That said, two questions remain to be answered. First, to what extent was experience in Imperial Ethiopia consistent with the political processes that linked taxation to broader processes of state building in early modern Europe? Second, to what extent was tax reliance a factor that specifically contributed to the expansion of responsiveness and accountability?

In order to answer these questions it is most useful to begin by returning to Tilly's (1990) model of state building and state formation. His model focuses on the complex interaction between external threats, domestic taxation and particular material conditions in producing specific political outcomes. He argues that when external threats necessitated increased domestic taxation, states were forced to bargain with taxpayers, and that this yielded particular political bargains that reflected underlying economic structures.

In England, where the capitalist class was relatively powerful, the need for greater taxation resulted in a relatively inclusive tax bargain between elites and the monarchy that created stronger institutions of representation and buttressed the rule of law and property rights. By contrast, the strength of the monarchy and of landed elites far exceeded that of the capitalist classes in most of Eastern Europe, including Russia, where agricultural production remained the primary economic activity. Given this balance of power, the need for taxation did not yield tax bargains that expanded representation and the rule of law, but instead gave rise to tax bargains between monarchs and landed elites that entrenched the coercive taxation of the peasantry. Landed elites retained local authority to extract revenue from a subjugated peasantry, while a share of those extractions was reserved for the central government. This model of state building generated significant revenue, and spurred the growth of powerful central bureaucracies, but did not produce meaningful institutions of broad based accountability.

In material terms Imperial Ethiopia most closely resembles the model that predominated in Eastern Europe and Russia: the economy rested on a feudal system of intensive agriculture,

with the peasantry subject to heavy taxation and control by a powerful landed nobility allied with the Emperor. As such, it is instructive to explore Tilly's (1990) account of experiences in Eastern Europe and Russia in slightly more detail, in order to frame the analysis of the Ethiopian case. Russia presents an exemplary case, as it was ruled for centuries by changing constellations of tribute-taking powers that exerted little direct control over the landlords and peasants within their territory. During the 15th century a period of consolidation began as tsar Ivan the Great (1462-1505) succeeded in subjugating competing landlords to his power. The rule of the tsars nonetheless remained indirect, as landlords and the church exercised authority at the local level and continued to constrain the power of the tsar. While the pressure created by successive external wars compelled the tsars to strengthen the central state and army, this involved further entrenching the power of feudal landowners, who were granted land and local authority in return for their military support.

The external threat posed by the Napoleonic Wars in the early 19th century accelerated the strengthening of the central bureaucracy, including the tax administration, as the tsar was slowly forced to take on the power of landed elites. By the late 19th century Russia had emerged as a powerful autocratic state, with a highly developed bureaucracy to organize the extraction of resources from the peasantry, but the tsar nonetheless remained "totally dependent on the cooperation of landlords" (Tilly 1990: 160). While the system in place was thus able to sustain the state, it masked lingering tensions: reform of the profoundly coercive and exploitative character of rural relations was halting and slow, while the tsar remained beholden to landed elites despite the emergence of a growing capitalist class. While this is an exceptionally simplified picture of Russian history, it captures the basic nature of the tax bargain that underpinned the state, but which also left important tensions unresolved. These tensions eventually contributed to the Russian Revolution of 1917 (Tilly 1990, Pipes 1995).

While the Russian case is, of course, unique, the basic model of a coercive, and ultimately untenable, tax bargain between the monarchy and landed elites is not. In France, the fiscal basis of the monarchy lay in a not dissimilar accommodation, as landed elites were granted

regional power and extracted tax revenue from a relatively powerless peasantry. There too this tax bargain generated significant tax revenue up to a point, but also led to high levels of exploitation in the countryside while failing to accommodate the demands of the growing capitalist class. Far from being resolved through a more inclusive tax bargain to expand accountability, these factors figured prominently in the eventual outbreak of the French Revolution.

What, then, can this tell us about the experience of Imperial Ethiopia? If these general insights about taxation and state building in early modern Europe are relevant to understanding state building in a broader range of contexts, then we would expect the Ethiopian experience to reflect broadly similar patterns. While every context is certain to be unique, we would specifically expect to observe three broad patterns that are relatively common features of the tax narratives from Russia, France and much of Eastern Europe: first, that external threats created incentives for strengthening the central bureaucracy in order to increase tax revenue collection and establish central government authority; second, that conflict over taxation led to important processes of tax bargaining between the government and taxpayers, and particularly elites, through which the government succeeded in meeting its revenue needs; and, third, that while periodic tax bargains succeeded in meeting revenue challenges, the continued failure of the government and landed elites to arrive at a more inclusive tax bargain contributed to eventual crisis.

In practice, the experience of Imperial Ethiopia conforms quite closely to these three broad expectations, and what follows summarizes the evidence for each one in turn. Taken in its entirety the evidence supports the contention that political processes linking taxation and state building are not particular to Western experience, but have broader relevance. It is also a reminder that while the need for governments to raise tax revenue can contribute to the expansion of responsiveness and accountability such positive outcomes are far from guaranteed; tax bargaining is shaped by the broader social, economic and political context and may equally result in the granting of privileges to elites. We return to this issue in the conclusion to this chapter.

3.2.1. External Threats, Tax Revenue and the State

The connection between external threats and taxation is central to historical research about taxation and state building. In early modern Europe external threats were central to generating incentives for increased tax collection and the extension of central government authority, both of which required significant strengthening of central bureaucratic structures. Yet the historical role of external threats in motivating increased taxation, and corresponding administrative gains, has been less studied, and more contentious, in the developing world. Centeno (1997) has explicitly argued that war did not contribute to institution building in Latin America owing to a combination of the availability of external resources, the limits of state organizational capacity and the weakness of social bonds within states. Meanwhile, while accepting the importance of external threats in principle, Jackson (1991) and Herbst (2000) have argued that in most of sub-Saharan Africa external threats were not essential to shaping the growth of states, owing to historically low levels of inter-state warfare. They see this absence of external threats as a key explanation for the limited administrative capacity, territorial control and accountability exhibited by many African states to the present.

In contrast to this earlier research, external threats and warfare were an important catalyst for the expansion of state authority and the strengthening of administrative capacity in Imperial Ethiopia. During the 19th Century it was the rise of external threats from Egypt and Europe that played a central role in prompting processes of centralization under Tewodoros, Yohannes and, most importantly, Menelik. Whereas Ethiopia was long governed by shifting constellations of regional elites, responding to these external threats required an increasingly centralized, and well resourced, central government. Throughout this period the extension of taxation was thus both an explicit effort to increase government revenue and an implicit means to signal the spread of central government authority.

The importance of revenue considerations in shaping the centralizing activities of successive Emperors is clearly apparent. Early on it was conflict with the Church for control of significant tax revenue bases that figured prominently in Emperor Tewodoros' loss of power. Even more striking was the centrality of revenue considerations to

Menelik's efforts to expand the borders of the Ethiopian state. His control over new revenue sources, achieved through his conquest of the south-west, was central to his emergence as Emperor and later to his ability to rebuff the Italian invasion of 1896. While Ethiopia increasingly took on the characteristics of a modern state under Emperor Haile Selassie, external threats, and the consequent need for increased central government revenue, remained a central concern. Most notably, the Ethiopian defeat at the hands of the Italians in 1936 emerged as an important catalyst for the rapid tax reforms of the 1940s, and for the political conflicts that these engendered. Thus a careful reading of history makes clear that increasing external threats created strong incentives for the central government to expand taxation in order to increase central government revenue and more generally establish central government authority. These efforts, in turn, required major new investments in strengthening the bureaucratic capacity of the state.

While the importance of external threats to the broader evolution of taxation and public administration in Ethiopia is thus evident in studying the historical record, it is equally apparent in the unique characteristics of the contemporary Ethiopian state. A defining feature of most sub-Saharan African states is their limited ability to effectively project power in rural areas, reflected most glaringly in the weakness of taxation, and state capacity more generally, at the local government level. By contrast, the contemporary Ethiopian state has an impressive ability to implement policy, and collect taxes, in even relatively remote areas, and this capacity appears to have strong roots in the unique history of state building in the country (Stahl 1989).

The system of land taxation provides a particularly insightful perspective on the unusually broad reach of the Ethiopian state. In most of sub-Saharan Africa local taxation is extremely weak, and the systematic taxation of land and property particularly rare, despite the fact that such taxation exists in law.⁸ By contrast, Ethiopian governments from the Imperial period to the present have doggedly pursued the collection of agricultural taxes

⁸ Detailed data on the share of rural land taxation in total revenue is not readily available in any country in the region other than Ethiopia as far as the author is aware. This in and of itself speaks to the absence of effective taxation, while this research has already noted the exceptionally small share of local taxation in total revenue even in ostensibly decentralized countries like Ghana.

linked to land holdings. Research conducted in 2004-05 found that the actual collection of land taxes in Amhara and SNNPR regions amounted to almost 90% of the estimated potential, which is a remarkably high rate of coverage given the administrative challenges involved (Warner et al. 2005a, 2005b).

This pattern appears to reflect Ethiopia's unique state building trajectory. Herbst (2000) has explained the weakness of administrative capacity at the local government level in most of sub-Saharan Africa by the fact that states have rarely faced significant territorial threats, and have thus had weak incentives to extend taxation, and thus the broader administrative presence of the government, into rural areas. By contrast, Emperors Menelik and Selassie in particular had strong practical incentives to strengthen the system of land taxation. They were confronted by significant external threats from the European powers, and by a long historical tendency towards internal fragmentation, and their claims to power rested entirely on their ability to project effective power throughout the territories that they claimed. In seeking to extend their claims to power the tax system was invariably the leading edge of the administrative presence of the state. Thus, Menelik focused on establishing taxation in the south-west in order to establish effective control after his conquest, while Emperor Selassie's decision to create a paid revenue bureaucracy formed part of his efforts to undermine the countervailing power of the landed elite. Slightly later, the politically costly reestablishment of rural taxation after the Italian occupation appears to have reflected, at least in part, the need to reassert the authority of the Emperor in the countryside.

There is thus compelling evidence that external threats shaped the level and reach of domestic taxation, with consequences for the long-term character of the central state. The need to raise tax revenue and entrench the power of the central state contributed to the expansion of national borders, the construction of an increasingly effective central bureaucracy and to efforts by progressive Emperors to expand central authority over regional elites. This story has strong parallels with the history of taxation and state building in early modern Europe.

3.2.2. Tax Bargaining in Imperial Ethiopia

External threats thus generated the need for additional tax revenue, and this, in turn, forced the government to bargain with taxpayers. The core ‘tax bargain’ that underpinned the expansion of the Ethiopian state saw successive Imperial governments grant significant autonomy and rights to the landed nobility in exchange for allegiance and a share of the tax revenue extracted from the relatively powerless peasantry. This was a ‘tax bargain’ in the technical sense, and in the sense in which Tilly (1990) has employed the term in his historical cases, but it was not a tax bargain in the sense in which that term is used in this study, as it involved the granting of narrow benefits, including effective exemption from taxation, to a privileged minority, and entrenched the coercive taxation of the majority. It is consequently more properly thought of as an elite agreement, thus distinguishing it from broad tax bargaining between taxpayers and governments.

This agreement between the government and the landed nobility consequently does not offer direct evidence that tax reliance contributed to the expansion of responsiveness and accountability. However, although the concessions made to the nobility in this case effectively entrenched coercive taxation, the history of taxation in Imperial Ethiopia does nonetheless present individual examples of broad tax bargaining, which contributed to the expansion of responsive and accountable government. The most prominent examples occurred after Haile Selassie’s rise to power in 1930, as it was at this point that the central government began in earnest to attempt to tax both the landed nobility and peasant farmers directly, thus opening the door to genuine bargaining between taxpayers and the government.

The first example of note was the decision to create the Senate and the Chamber of Deputies in the 1930s. This decision appears to have been a direct concession to the landed elite as well as an effort to increase the legitimacy of the government’s reform program. The concession appears to have reflected specific tax concerns to a significant degree, as taxation was a central, and particularly controversial, component of the government’s reform agenda. Thus we have some evidence of a tax bargain in which limited

representation for the elite was provided in a pre-emptive effort to improve the government's ability to raise tax revenue.

Even clearer evidence of tax bargaining can be found in the decision to introduce the agricultural income tax. The extended political battle that ensued contributed to the strengthening of the Chamber of Deputies, to establishing a degree of regional control over government decisions and to the broader enhancement of bureaucratic capacity.

First, the role of the Chamber of Deputies was effectively transformed in response to the new tax. Despite the official powers granted to the Chamber, it exercised very little effective power, as the Emperor had always remained the focus of decision-making. This began to change in 1967, as the proposed agricultural income tax prompted the Chamber of Deputies to aggressively resist proposed legislation for the first time. In so doing its members succeeded in profoundly diluting the content of the law and, more importantly, permanently altered the political position of the Chamber of Deputies. Quoting Schwab (1972: 20): "The manner in which Parliament opposed sections of the bill has altered to some degree the process of rule-making. Certainly the role and reaction of Parliament was a surprise, if not a shock, to many of the bureaucrats and rule makers in the Ministry of Finance." Thus, while the Chamber of Deputies as a formal institution had long existed, the conflict over the agricultural income tax changed the informal institutions governing law making in the country. While it is important to remember that the Chamber of Deputies was an entirely elite institution, and had few claims to being broadly representative of the population, its empowerment nonetheless marked an unprecedented extension of decision-making influence.

In similar fashion the introduction of the new tax in Gojjam province led to significant tax bargaining, as tax grievances became a catalyst for airing deeper concerns about the encroachment and brutality of the central government. The armed rebellion that followed the introduction of the new tax resulted not only in the government reducing the tax burden, but also in a decision by the government to appoint a locally acceptable governor, along with various other senior government officials. While the rebels were not granted formal

powers of representation, the informal granting of influence over central government appointments was a significant political outcome that was catalyzed by the tax revolt. The fact that the peasant rebels were defending a feudal land tenure system that benefited elites confuses the interpretation of the outcome, as it suggests that elites succeeded, to a certain extent, in manipulating public fears for their own benefit. That said, there is little doubt that broader grievances about the encroachment of the central state, and the brutality of the governor, were powerfully felt by the rebels themselves, thus reinforcing the view that the tax revolt resulted in at least some broad-based gains.

A third outcome of the agricultural income tax was that it prompted the creation of significant new administrative capacity. The new tax called for the assessment of income, and this was far more administratively demanding than the comparatively simple taxation of land. The law originally called for expanding the capacity of the Ministry of Finance in order to send tax assessors throughout the country. In practice, resistance by the Chamber of Deputies led to the creation of local Tax Assessment Committees, along with a formal appeals process. Despite resistance to the new tax by local elites, Schwab (1972) argues that these committees were an important driver of broader bureaucratic modernization, while reliance on local Tax Assessment Committees and a formal appeals process marked a significant decentralization of power. Thus, again, there is evidence that tax bargaining contributed to the expansion of accountability, this time through the creation of stronger, and more inclusive, bureaucratic structures.

Moving away from the case of the agricultural income tax, the decision in 1942 to begin providing tax receipts to all taxpayers provides a final example of tax bargaining, as the measure was designed to enhance revenue collection, but was also a concessions to the peasantry designed to increase voluntary compliance. During the Italian occupation many land taxes had officially been abolished, and as such there was a risk of significant public opposition to the reinstatement of land taxes, as reflected in the centrality of tax grievances to the *weyane* rebellion. It was with this risk in mind that the government decided to link tax payments to the establishment of secure land claims, presenting the tax receipt as a sort of informal land title. Over time this policy became very popular with peasants. A 1960s

tax official explained that, “Peasants thought that the tax slip was for the land – that this slip recognized their control of the land. So they were willing to pay...This was a recognition and they wanted that recognition – before, they were the property of the landlord.” He went on to argue that, “rural people carried their tax receipt like an identity card.” This suggests that the government effort to strengthen peasant land claims in exchange for tax payment had important symbolic value despite its limited practical implications.

3.2.3. Unresolved Tensions and Revolution

The story told so far captures the extent to which the need for increased tax revenue, frequently driven by the presence of external threats, contributed to the expansion of central state authority and to important episodes of tax bargaining between taxpayers and the government. In at least some cases the expansion of taxation contributed to the strengthening of institutions of accountability and of bureaucratic forms of government.

Yet, despite these gains, the tax system remained fundamentally coercive. The landed nobility continued to bear only a modest tax burden, while the peasantry remained subject to a heavy tax burden and feudal exactions by the landlord class. Despite government reform efforts, there had been little change in the basic characteristics of a system that granted the landed nobility extensive local powers in exchange for allegiance and a share of local tax revenue being remitted to the central government. This failure of tax reform resulted from the inability of successive Emperors to fully overcome the power of the landed nobility and from the unwillingness of the landed nobility to enter into a more progressive tax bargain with government. The landed nobility understood that changes in taxation were linked to broader changes in the exploitative system that continued to prevail in rural areas, and thus maintained a relentless opposition to any change. In the short-term this opposition to fundamental changes in taxation, and in the broader rights of the peasantry, proved effective. Yet, in the longer-term the failure of the government and the landed nobility to arrive at a more inclusive tax bargain contributed to the broader societal tensions that eventually resulted in Revolution in 1974.

That the failure of tax reform contributed to the outbreak of revolution is reflected in the fact that in the lead up to the Revolution, a dominant issue among the opposition movements was the demand for 'land to the tiller'. While this demand for the reform of feudal control in the countryside was about more than taxation alone, the tax reform battles of the 1960s were proxies for the broader conflict. As early as the 1940s, proposed reforms had called for the abolition of feudal exactions in favour of private property rights and equitable taxation of all individuals. While these battles were motivated by the revenue needs of government, they were also tied to the broader goal of modernizing the countryside. At least part of the intelligentsia recognized the broader political centrality of the battles over agricultural taxation, and as a result the failure of tax reform fed the energy of the opposition movement (Eshetu Chole 1966).

At the same time that the opposition was spurred by continued exploitation in the countryside, it was also motivated by the government's simple failure to invest sufficiently in modernizing public services and infrastructure. This grievance likewise found its roots at least in part in the failure of the government and elites to arrive at a tax bargain that would raise greater revenue for the state. The fiscal weakness of the state was thus an important contributor to the outbreak of Revolution and the inability of the government and the landed nobility to agree on tax reform contributed to this weakness.

Indeed it could be said that the failure to arrive at a modernizing tax bargain reflected a failure to bridge the vastly different visions for the future of the country that were held by different elements within society. The landed elite persistently resisted change, while urban progressives refused to be satisfied with the slow rate of reform achieved by the government. The resistance of the landed nobility ensured that the government could never raise enough revenue to meet growing demands, while it also ensured that the government could not escape complaints about the gross inequities that continued to exist in rural areas. As in early modern Eastern Europe and Russia, the feudal system provided a viable model for collecting the revenue necessary to expand the military and bureaucratic power of the state, but ultimately proved unable to reform itself in the face of rapid change. Quoting Gebru Tareke (1991: 96), "It's [the gentry] members' obstructionist activities that

eventually helped to pave the way to the revolution that destroyed all of them along with the old regime.” While the battle over taxation was only one part of a broader story, the failure of the government and the landed nobility to arrive at a more inclusive tax bargain appears to have played a meaningful role in the genesis of Revolution.

3.3. Conclusions

The argument that the need for taxation may contribute to the expansion of responsiveness and accountability derives overwhelmingly from the experience of state formation and state building in early modern Europe. This raises the question of whether the centrality of taxation to state building in early modern Europe was historically unique, or potentially holds broader lessons for other parts of the world. This chapter has argued the latter, presenting evidence that taxation was central to processes of state formation and state building in Imperial Ethiopia and that the Ethiopian experience had much in common with broad narratives of taxation and state building in early modern Europe.

This is not to claim that taxation has necessarily played a similar role elsewhere on the continent, or in the developing world, as Ethiopia is interesting precisely because of its unique history, which differed dramatically from the rest of sub-Saharan Africa. Instead, the evidence in this chapter argues that the importance of taxation to state building is not specific to any particular region, culture or historical period, but is instead grounded in particular economic, social and political conditions that appear to facilitate tax bargaining. The economic and political system in Imperial Ethiopia had much in common with the economic and political systems of early modern Europe, and particularly of Eastern Europe and Russia, and the centrality of taxation to state building in Ethiopia correspondingly bears much in common with earlier experiences in those countries.

Notably, this experience does not particularly resemble the model of tax bargaining that contributed to the emergence of parliamentary government and the rule of law in England. In Imperial Ethiopia the need for increased tax revenue yielded important tax bargains over time, which contributed to slow improvements in the responsiveness and accountability of government. Yet, the government and the landed nobility were persistently unable to arrive

at a more fundamentally modernizing tax bargain that would have helped to contain the growing tensions within society that ultimately led to Revolution. The Ethiopian experience thus highlights the potential for tax bargaining to be a catalyst for the expansion of responsiveness and accountability, but also the reality that such tax bargaining is far from guaranteed. The landed nobility in Ethiopia, like their historical predecessors in early modern France, Russia and elsewhere, preferred to defend narrow privileges rather than enter into a more progressive tax bargain, even as this resistance contributed to social instability.

Having thus made an empirical case for studying the centrality of taxation to state building in diverse contexts, the thesis now turns to an investigation of the importance of tax bargaining to the expansion of responsiveness and accountability in contemporary sub-Saharan Africa. The next chapter presents econometric tests of the relationship between taxation and accountability, and concludes that while cross-country data is consistent with such a relationship it is insufficient to convincingly establish a causal relationship. This, in turn, argues for case study research that can cast new light on the causal processes at work.

The subsequent chapters correspondingly present contemporary case studies from Ghana, Kenya and post-1974 Ethiopia. Both the style and content of these contemporary case studies differs quite markedly from the preceding discussion of Imperial Ethiopia, and this reflects the quite different social, economic and political context. While this chapter has captured specific episodes of tax bargaining, the focus has been on the longer arc of state building. The discussion has emphasized the importance of external threats, the gradual emergence of a strong central government, the halting construction of a centralized tax system and broader struggles over political and economic modernization. By contrast, the contemporary case studies reside within a much more narrowly institutionalized context: external threats are minimal, the basic authority of central states is widely accepted (despite their frequent weakness), relatively standardized tax systems are the norm across the developing world, liberal economic policies are ubiquitous and formal democracy has spread rapidly, even if it is frequently limited in practice. As such, the analysis in the subsequent case studies focuses less on the broad arc of state building, and more narrowly

on specific tax episodes around which taxpayers have sought to implicitly and explicitly bargain with governments to achieve the expansion of responsiveness and accountability.

4. Cross-Country Econometric Evidence: Tax Reliance and Accountability

The previous chapter presented an empirical case for studying the relationship between tax reliance and the expansion of responsiveness and accountability in the developing world. While the details of Ethiopian state building are unique within sub-Saharan Africa, the broad message that emerges from the previous chapter is that the political processes through which taxation shaped broader political outcomes in early modern Europe have been equally relevant in a non-western environment. While far from constituting proof that these processes have been equally relevant everywhere, this empirical evidence provides a far stronger justification than has previously been available for investigating the role of similar political processes in contemporary sub-Saharan Africa.

This chapter correspondingly presents novel econometric tests of the cross-country relationship between tax reliance and accountability in sub-Saharan Africa.⁹ While the remainder of the thesis relies heavily on case study evidence, there are several reasons to begin with cross-country econometric tests. First, the research question is, in principle, ideally suited to cross-country comparison, as it yields a clear prediction about the impact of different levels of tax reliance on levels of political accountability. Cross-country analysis thus holds the potential to overcome the risk of bias in small-n analysis, by asking whether the predicted relationship holds, on average, across all countries in the region. Second, the initial quantitative results reported here are important for shaping the case selection strategy, consistent with the logic of “nested-analysis” outlined in chapter 2. Finally, econometric evidence has previously played a prominent role in shaping our understanding of the relationship between tax reliance and accountability in the developing world through a series of well-known studies. There is a consequent need to engage with this existing evidence before seeking to draw new or more nuanced conclusions.

⁹ While the research hypothesis focuses on both responsiveness and accountability, only accountability offers a set of cross-country indicators for econometric analysis, though even these indicators are highly imperfect, as is discussed in more detail later in the chapter.

Existing econometric studies have generally argued that governments that are more reliant on tax revenue are more likely to be accountable to their citizens. This includes three particularly well known cross-country studies (Ross 2004, Mahon 2005, Timmons 2005), which have been buttressed by two sub-national studies (Hoffman and Gibson 2005, Gervasoni 2010). But while these consistently positive results are encouraging, they are also potentially misleading, as researchers have been forced to rely on highly imperfect methods and data (Haber and Menaldo 2009). This chapter is thus devoted to revisiting the particularly influential cross-country results, while paying particular attention to methodological and data problems in order to test the robustness of existing results and propose more nuanced conclusions.¹⁰

With this goal in mind, the first section of this chapter explores the general methodological and data challenges encountered by cross-country studies of tax issues. It presents an extended discussion of available econometric methods and of the measures taken to improve the coverage and accuracy of the data used in the econometric tests. The second section presents the econometric tests and results. The tests follow a similar econometric strategy to earlier studies but employ improved data and greater econometric caution. The results reveal that while available data is *consistent* with the hypothesis that more tax reliant states are more likely to be accountable, it is not possible to decisively establish *causation*, contrary to earlier findings. The third section concludes by arguing that the absence of conclusive econometric evidence of a causal relationship between tax reliance and accountability does not necessarily imply the absence of a causal relationship in practice. Instead, the ambiguous results can be explained by a combination of enduring data problems and the inability of standard cross-country econometric methods to capture the complexity of the causal processes at work. The results in this chapter thus suggest that existing econometric work has offered an overly simplistic view of the relationship between tax reliance and accountability, thus arguing for detailed case study evidence that can cast new light on the question.

¹⁰ The analysis focuses on extending existing cross-country studies because they have been particularly widely cited and influential in the field; they have tested the research hypothesis very directly; they most closely reflect the national, comparative, focus of the case studies to follow; and they are based on widely available data and are thus more easily subject to replication and extension.

4.1. Methodological Challenges

The use of statistical methods to investigate political science questions has become increasingly common over time. This development has obvious advantages, as such methods are able to guard against the risks of case-selection bias, and provide significantly more leverage for distinguishing those variables that actually drive outcomes from those that are prominent but largely idiosyncratic.

That said, while statistical methods are ideally suited to dealing with relatively deterministic relationships, significantly more caution is needed when applying such methods to the contingent relationships that characterize much of political science. Regression methods are best suited to capturing linear and probabilistic relationships; where there are multiple, quite different, causal pathways at work, or where outcomes are contingent on intervening factors, simple econometric models may misrepresent the underlying relationship. At a more methodological level, studies that rely on relatively small cross-country data sets face inherent econometric challenges that demand careful attention. Several recent studies have noted that the expanded use of statistical methods in political science has not been matched by the development of a robust and widely understood methodological literature. As a result many studies have applied overly simplistic methods, or, more often, have failed to sufficiently address concerns about the robustness of results (Wilson and Butler 2007, Beck and Katz 1995, Beck 2001).

Wilson and Butler (2007) found in a recent survey of statistical studies published in major political science journals that less than 5% employed a battery of methods consistent with what they considered to be minimum levels of statistical rigor. They went on to conduct a more detailed study of eight published papers, and found that several key results were significantly altered, or in some cases even reversed, when relatively modest alternative specifications were implemented. In a similar vein, an earlier paper by Beck and Katz (1995) persuasively demonstrated that several key statistical results in the field were driven by the application of inappropriate statistical methods, which artificially inflated the statistical significance of explanatory variables.

Even when appropriate methods are adopted there are potentially intractable questions about the ability of available methods to deal with the statistical challenges inherent in working with time-series cross-section (TSCS) data, on which many studies in political science rely. When relying on observations for multiple countries over multiple years, the number of observations is necessarily small. As a consequence, panel data models that rely on the asymptotic properties of the estimators, and thus become unbiased and efficient in large data sets, may encounter significant problems when applied to TSCS data (Beck and Katz 2004). At a more specific level TSCS data are plagued by unit heterogeneity, correlation between the observations over time and across units, and panel heteroskedasticity (Wilson and Butler 2007).

4.1.1. Fixed-Effects Models

The most basic challenge facing studies using TSCS data is unit heterogeneity, which refers to the fact that country specific factors may lead to systematically higher or lower levels of the dependent and independent variables in individual countries. In the specific case of taxation, existing studies establish quite clearly that some countries have consistently high levels of tax collection, and vice versa, for historical reasons of path dependency (Bird 2008, Lieberman 2002). The most common approach to dealing with unit heterogeneity is the use of fixed-effects models. Fixed-effects models include a dummy variable for each country in the sample, which accounts for unobserved characteristics of individual countries that result in persistently high or low levels of the dependent variable. Intuitively, fixed-effects models focus attention on the movement of the dependent and independent variables over time *within a particular country*, while differences in collection across countries are captured by the country-specific dummy variables, and thus not reflected in the regression coefficients.

Rather than asking whether countries with high levels of tax reliance also tend to be more accountable, fixed-effects models ask whether, within countries, accountability has been higher when tax reliance has been higher. This is a much more robust specification, as it eliminates the risk that results are driven by persistent, but unobserved, characteristics of individual countries. The primary disadvantage of fixed-effects models is that they

preclude the use of time invariant variables, which are captured by the fixed-effects term, and reduce the explanatory power of variables that change slowly over time. Moreover, because fixed-effects models only capture changes within countries over time, statistical relationships that precede available time series data are not captured. This emerges as a serious problem for quantitative studies of taxation, as the impact of reliance on non-tax revenues is of particular interest, but resource dependence often predates available data.

4.1.2. Panel Corrected Standard Errors and Lagged Dependent Variables

Aside from unit heterogeneity, there is also a need to address the econometric problems posed by panel heteroskedasticity, contemporaneous correlation and serial correlations, each of which violates the assumptions needed for standard ordinary least squares (OLS) regressions. Panel heteroskedasticity refers to the possibility that different units in the panel may have different error patterns or may have key variables of significantly different magnitudes. Contemporaneous correlation refers to the possibility that the movement of variables in one country may be correlated with movements in variables in other countries, for example in the case of two interdependent economies. Finally, serial correlations refers to the fact that the values of individual variables may be persistent over time, causing the error terms to be correlated over time, in violation of the OLS assumptions.

Simultaneously dealing with these problems in TSCS data is relatively complex and has given rise to a significant methodological debate. An early solution was the use of Feasible Generalized Least Squares (FGLS), which used the error terms from a standard OLS regression to adjust the data and eliminate the impacts of serial correlation, panel heteroskedasticity and contemporaneous correlation. Unfortunately, analysis by Beck and Katz (1995) has determined that while this method is reasonably effective for dealing with bias in the estimation of the coefficients it frequently yields standard errors that are significantly over optimistic. Beck and Katz (1995) consequently recommended the use of Panel-Corrected Standard Errors (PCSEs) to deal with panel heteroskedasticity and contemporaneous correlation, while PCSEs can be combined with a Prais-Winsten

regression in order to correct for serial correlation. They have demonstrated that in most real world applications PCSE models have superior estimating properties to FGLS.

While this solution is reasonably effective, Beck (2001) argues that the preferred method is to directly model the temporal dynamics of serially correlated data through the inclusion of a lagged dependent variable (LDV) as an explanatory variable. This has the advantage of addressing the dynamics of the data directly, rather than treating those dynamics as a “nuisance” to be eliminated. But while this presents a nice solution in some cases, it also introduces new risks, as it can create bias in the estimation of the coefficients. Achen (2000) has demonstrated that the use of LDVs in fixed-effects models can artificially suppress the explanatory power of other variables in the regression, even leading to sign reversals in some cases. Kristensen and Wawro (2003) have since demonstrated that the risk of a high degree of bias is most acute when the inclusion of an LDV fails to fully eliminate serial correlation in the data, and argue that in such cases the use of a fixed-effects model with robust standard errors is likely to be more reliable.

Several alternative dynamic models, which seek to model serial correlation directly, have emerged in an effort to deal with the risk of bias that results from the use of LDVs. The most popular are a group of generalized method of moments (GMM) estimators designed to overcome the bias introduced by the joint introduction of LDVs and fixed effects under OLS. The most well known is the Arellano and Bond (1991) GMM estimator, though it is particularly appropriate to situations with many individuals and a short time period, which does not strictly describe the data used here (Roodman 2006). More generally, while these and other relatively sophisticated dynamic models are attractive in principle, Beck and Katz (2004) suggest that simpler models generally perform equally well and are thus likely to be preferable where data is imperfect.

Overall, debates over the optimal strategy for dealing with TSCS data lead to two conclusions. First, the robustness of existing studies and results should be evaluated in light of these methodological risks. Second, the imperfect nature of available methods argues for a progressive data analysis strategy, which begins with simple and intuitive tests and builds

towards more sophisticated models. These two lessons underpin the analysis presented later in this chapter.

4.2. Improving Data Quality

While econometric challenges are deeply important, they can distract attention from much more basic, but at least equally important, problems of data quality. This challenge relates both to the simple availability of data, and to the careful construction of datasets such that the data reflects what it actually of interest and is comparable across countries. Both of these issues are relatively acute when dealing with tax data, and appear to have been poorly addressed by previous studies. What follows explains the scope of these problems in more detail and introduces the measures adopted here to address these concerns.

4.2.1. Poor Data Quality and Availability

One of the dominant features of tax data in sub-Saharan Africa is the extent of missing data, while the quality of available data is also questionable. The extent of missing data generates major concerns about case selection bias, as the missing data is almost certainly non-random and concentrated in resource dependent states, states involved in conflict and those with poor relationships with the International Financial Institutions (IFIs). Tellingly, Ross's (2004) widely cited study of the relationship between tax reliance and accountability covers only 1633 of a possible 3051 observations, while coverage is even more limited for non-OECD countries. Table 4.1 provides a further indication of the extent of missing data in a number of recent tax studies.

Table 4.1: Data Coverage in Existing Tax Studies

Author	Year	Observations	Country Coverage and Notes
Ross	2004	1633/3051	Low coverage despite inclusion of OECD countries, for which data is readily available.
Gupta et al.	2004	1943/3317	Covers all developing countries from 1970-2000. Total observations fall significantly in several specifications.
Mahdavi	2008	769/1290	Low coverage despite focusing on only 43 countries, of which 11 are from sub-Saharan Africa
Gupta	2007	1875/2625	Relies on total government revenue, as opposed to total tax revenue. This offers greater coverage, but alters the research question.
Stotsky and Woldemariam	1997	170/258	The authors limit their sample to 1990-95, and exclude Liberia and Somalia, in order to improve coverage.

Historically, the primary sources of tax data have been the IMF's Government Financial Statistics (GFS) and the World Bank's World Development Indicators (WDI). In both cases regular data availability begins at the beginning of the 1970s, but both databases cover at best half of available country-year observations for developing countries.¹¹ Data problems are exacerbated by the fact that neither source is entirely continuous throughout the period due to methodological changes. The IMF GFS adopted a new methodology at the beginning of the 1990s, creating a structural break in the data-series, while the WDI after 2002 omit significant data contained in earlier versions of the dataset. Prevailing practice, which is followed here, has been to merge the different versions of the data sets despite these inconsistencies, but this raises additional questions about the validity of the data.

More recently additional data sources have become available, but this has not solved the problem of missing data. The World Bank's Africa Development Indicators (ADI) dataset contains more data than the WDI, but does not cover all tax categories and still contains significant gaps. An alternative is to rely on country-by-country data drawn from Statistical

¹¹ This statement is necessarily vague, as the number of observations varies depending on the edition of the databases that is consulted, while some of the data in both datasets is transparently inaccurate.

Appendixes compiled by IMF staff. These publications provide relatively detailed and complete data, but are generally only publicly available beginning in the early 1990s. These documents have been an under-used resource in existing studies, seemingly owing to the fact that the IMF does not make the data available in a single dataset or in an entirely consistent format across countries.

As troubling as the gaps in data availability is the fact that reported data often varies significantly across sources. It is relatively common to find that reported tax revenues differ by 5-10% or more between at least two of the available data sources, while there are occasionally very large differences between IMF and WB sources during the 1970s and 1980s. This problem is compounded by equally frequent differences in reported GDP figures across sources, as many tax studies, including this one, rely on measuring tax revenue as a share of GDP. The problem with GDP figures appears to have become more acute in recent years, as many countries have adopted new methodologies for calculating GDP, but these new methodologies, which generally lead to higher estimates, are not always retroactively applied to earlier data.

Despite these well-known problems, disappointingly little has been done in most studies to address them. This particularly raises questions about the relevance of existing results to the underrepresented sub-Saharan African sample. To take a striking recent example, a study of income taxation by Bird and Zolt (2005) reports the average level of income tax collection in Africa, but the sample comprises only eight countries, of which two are islands (Madagascar and Mauritius), one is in North Africa (Morocco) and two are the exceptional cases of South Africa and Lesotho.

4.2.2. Constructing a More Complete Data Set

In the absence of more complete data, the results of econometric studies will remain open to question. This research has sought to improve the quality of the underlying data by drawing on each of the data sources discussed above in order to construct a more complete

dataset. The resulting dataset covers 45 countries from 1972-2005¹², and includes 1214 observations out of a theoretical potential of 1530. In practice coverage is much more complete than these aggregates suggest, as the majority of the missing data is from countries that did not begin reporting data until after 1972¹³, or for which 2005 data is not available. After excluding these two issues total coverage is 1146 out of a possible 1236 observations.

While drawing on multiple data sources has allowed a vast improvement in data coverage, it is not without significant difficulties and risks. Any effort to merge different datasets raises the risk that the datasets are not recording precisely the same information. This, in turn, means that trends in the merged data may reflect differences in data sources rather than differences in reality. Given that there are sometimes significant differences in the tax data reported by different sources, the potential for errors when merging data would appear to be significant.

This risk must thus be balanced against the risks inherent in using very incomplete data. Deciding on the best course is, in turn, largely dependent on assessing just how large and problematic the data discrepancies across sources are. To take one example, the IMF itself advises against merging data from the IMF GFS before and after 1990 due to changes in methodology. In practice, researchers often merge those two datasets, as the methodological changes seem to have a limited impact on the data, at least in developing countries where available data is highly aggregated and imperfect to begin with.

The dataset used here reflects a judgment that the benefits of data merging outweigh the risks. The first stage of merging the various data sets proceeded as follows. First, the IMF GFS was adopted as the baseline data source, as it is the mostly widely used, and detailed, source available. Second, missing data points were filled using data from the WDI

¹² This excludes Somalia, for which no revenue data is available for any periods, and Togo, for which data needed to be entirely excluded because it has so far been impossible to credibly separate resource rents from reported income tax revenue (this is discussed further later in this chapter).

¹³ In many countries independence was not achieved until later than 1972, including Eritrea, Namibia, Angola, Mozambique and Zimbabwe, among others

wherever data was available. Third, remaining missing data was then filled using data from the ADI and from the IMF Statistical Appendixes. Finally, GDP data was drawn from the IMF International Financial Statistics, with missing values drawn from the ADI.

The second stage was relatively more complex, as it involved identifying instances where the data merger appeared to be problematic, and then correcting resultant problems. This process was driven by three broad questions. First, when data from two different sources is combined is the overall trend credible or is there an unusual, and unlikely, jump in the data? Second, where there are unusual shifts in the data, can they be explained by economic or political events or do they appear to be errors in one or the other of the data sources? Third, where different sources are drawn on to provide different revenue components (for example total tax revenue from the IMF, but trade and goods and services tax revenue from the ADI) are the various components internally consistent and compatible?

Where there were unexplained breaks in the data, or major disagreements across data sources, it was then necessary to make somewhat subjective choices. This involved asking three additional sets of questions. First, are the general trends in the data consistent across sources? Where they are not, can other sources support one or the other trend as being more accurate? Second, where different sources present different data, which value(s) is most credible? Is one or the other value a better fit within the longer-term trend? Third, where there are individual missing data points is it credible to impute the missing data from surrounding observations or does alternative information about the country (i.e. wars or coups) suggest a more fundamental disjuncture, demanding that data be omitted?

In practice, conflicting data sources generally had periods of overlap and agreement, which facilitated the data merging process. While it would be unwieldy to attempt to document the specifics of this process in detail here, the source for each observation is documented in the dataset itself, which is available in full upon request. Despite every effort to be systematic and transparent, the data merging process was inherently imperfect, particularly due to elements of subjectivity. That said, there is every reason to believe that this process is far superior to existing alternatives. Even selecting a single data series implies a high

degree of subjectivity given the stark differences between data sources, quite apart from the intolerable level of missing data. The process undertaken here has at least sought to make educated choices based on all available data. While there is no doubt room for improvement, this data set almost certainly represents broad trends over time much more accurately and completely than available alternatives that have been employed in past studies.

4.2.3. Data Corrections

Alongside the need to construct a more complete and accurate dataset lies the need to ensure that the data is an accurate reflection of the concepts of interest, and that it is comparable across countries, but this issue has also been frequently overlooked by existing studies. The most glaring problem relates to how existing data deals with resource rents, while there are also issues related to the treatment of decentralized revenue collection and the allocation of trade and goods and services taxes.

4.2.3.1. Dealing with Resource Rents

Most studies of taxation rely on drawing a sharp distinction between traditional sources of domestic tax revenue and resource rents. Unfortunately, existing sources of tax revenue data do not draw this distinction so clearly, or in a consistent manner.

Some countries with access to resource rents record that income as non-tax revenue, particularly when the resource is exploited by state owned firms, as is common in the Middle East. Other countries record resource rents as taxation, most commonly as a combination of corporate income taxes and royalties. This is common where private firms exploit the resource and then pay taxes to government. Finally, some countries record resource rents under both categories, for example recording corporate income taxes as tax revenue while listing royalties or production sharing revenues as non-tax revenue. While the resource rents in the latter two cases are, technically, taxes, they are, in analytical terms, best treated as non-tax revenue because they represent a captive income source for government that does not rely on the domestic citizenry.

It is essential that any econometric study treat resource rents in a consistent fashion across countries, but existing studies have often failed to do so, or even to explicitly acknowledge the problem. For this study, every effort has been made to treat all resource rents as non-tax revenue, though this process is, unfortunately, very difficult to achieve with precision. For years after the early 1990s it is generally possible to draw on data from the IMF Statistical Appendixes to make the necessary adjustments, as these reports generally report resource revenues as a separate category for countries where such revenues are large. Making adjustments for earlier years is much more problematic, as it is necessary to draw on external sources to estimate resource rents during those years. This study draws heavily on estimates originally produced by Mahon (2005),¹⁴ but, unfortunately, it becomes clear upon inspection that his estimates, while much better than pre-existing data, still sometimes significantly underestimate the share of resource rents in total revenue. In these cases there has been little choice other than to draw on all available data, including country specific sources, and then extrapolate trends to intervening years, and these decisions are fully documented in the data set. While frustratingly imprecise, the only alternative is to drop affected observations entirely, as was done in the case of Togo, where large fluctuations in minerals production over time, and an absence of alternative data sources, made extrapolation an unrealistic approach.

4.2.3.2. Central, Regional and Local Government Tax Revenue

A second issue is that previous work has generally relied exclusively on central government tax revenues. This is problematic in so far as it understates, sometimes dramatically, the total level of tax collection in federal and fiscally decentralized states. This is a minor issue for this study, as countries in sub-Saharan Africa are overwhelmingly centralized and the two federal states, Nigeria and Ethiopia, appear to report virtually all revenue as central government revenue in the relevant databases. That said, the question of state and local government revenue raises significant questions about earlier studies, as most OECD nations, as well as a significant number of large developing nations, derive substantial revenue from the sub-national level. Any regressions involving these countries will have been seriously biased by the underestimation of actual revenue collection in certain states.

¹⁴ Sincere thanks are due to James Mahon for this work, and his generosity in sharing the estimates.

4.2.3.3. Disaggregating Trade and Goods and Services Taxes

A final issue is ambiguity in the way that tax revenues are allocated between trade and goods and services taxes. This confusion arises from the fact that many goods and services taxes are collected at the point of import. Some countries record this revenue as goods and services taxation, while others include the revenue as trade tax revenue, presumably because it is collected by customs agencies. Over time the situation is further complicated by the fact that changes in tax laws can lead to changes in the way that revenue is allocated. Thus, for example, many countries experienced major shifts at the time of implementing a VAT.

It should, in principle, be possible to correct for this problem for years in which IMF Statistical Appendixes are available, but it is less clear whether there is a reliable means to correct for the problem in earlier years. The result is that any research that claims to distinguish between trade and goods and services taxes for econometric purposes must be carefully examined. There is a strong suspicion that this issue has been handled imperfectly, if at all, by some existing research, with consequences for the reliability of those results. For the purposes of this paper, the difficulty of solving this data problem has meant that none of the results directly rely on either the trade or goods and services sub-categories of taxation.

4.3. Testing the Relationship

The preceding discussion of methodological and data issues sets the stage for testing the relationship between tax reliance and accountability. As was noted in the introduction, several previous studies have sought to address this question econometrically. Most frequently cited is pioneering cross-country work by Ross (2004), who explicitly tested the hypothesis that states that are more reliant on tax revenue are more likely to be democratic. He concluded that there is compelling cross-country evidence of a positive and causal relationship. This finding is echoed by methodologically similar work by Mahon (2005), who finds a weaker, but still positive, relationship between tax reliance and accountability after improving both data quality and the econometric methods employed.

These findings are buttressed by work at the local level by Hoffman and Gibson (2005), who present evidence that localities in Tanzania and Zambia that are more reliant on own-revenues spend a greater share of their budgets on public services. In a similar vein, Gervasoni (2010) reports evidence of reduced democratic competition in Argentinean states that are more reliant on fiscal transfers and resource rents. Finally, Timmons (2005) approaches the question slightly differently, reporting cross-country evidence that the types of taxes that states collect are reflected in the types of services that they provide. He argues that states that rely on broad-based indirect taxes are more likely to focus on providing broad-based public services, while governments that rely on income tax revenue, primarily from elite groups, are more likely to favour elite interests, which he measures by the level of protection of private property rights.

While these studies present a seemingly persuasive body of evidence, there are important reasons for scepticism. The first reason is the weakness of available data, which has already been discussed at length. By employing a new, and much improved, data set the econometric tests to follow stand to dramatically improve on existing findings. The second reason for scepticism is the difficulty of establishing causality when testing the relationship between tax reliance and accountability. Putting aside, for now, more specific questions about variables and measurement, the research hypothesis predicts that, *ceteris paribus*, countries that are more reliant on tax revenue will be correspondingly more accountable.¹⁵ Unfortunately, there is a glaring problem of endogeneity, as tax reliance may cause greater accountability, but greater accountability may likewise be the cause of increased tax collection and tax reliance. The latter possibility is raised in several recent studies which have specifically asked whether greater accountability leads to greater tax collection, rather than the reverse (Bird, Martinez-Vazquez and Torgler 2004, Cheibub 1998). This endogeneity problem is, in fact, explicit in the research hypothesis itself: tax reliance is expected to lead to increased accountability precisely because governments recognize that they can increase tax revenue by being more accountable. As a result, even if it is true that, all else being equal, more tax reliant states are also more accountable, there remains the

¹⁵ At a purely descriptive level, it is near universally accepted that high-income countries are both more likely to be democratic (Reuschemeyer, Stephens and Stephens 1992) and more likely to have high levels of tax collection (Gupta 2007). This, though, is evidently not evidence of causation in either direction.

challenge of establishing that tax reliance is the cause of greater accountability, rather than the reverse.

With this challenge in mind, the next section introduces the dependent and independent variables, and is followed by an explanation of model specification and the econometric strategy employed to address the problem of endogeneity. This is followed by the presentation of the empirical results and, finally, by a discussion of interpretation and implications.

4.4. Selecting Dependent and Independent Variables

At a descriptive level, the dependent and independent variables of interest are straightforward, as the level of accountability is expected to be a function of the level of reliance on tax revenue. Unfortunately, the measurement of these concepts presents a significant challenge. With respect to the dependent variable, what is the most effective way to measure accountability across countries? With respect to the independent variable, what is the most appropriate means to measure tax reliance? These questions are addressed in turn.

4.4.1. Dependent Variables

Accountability is a broad concept and comprises a combination of formal and informal elements. This implies that cross-country indicators of accountability inevitably face both definitional challenges and significant measurement problems. While bearing these limitations in mind, the econometric tests presented here follow existing researchers in testing three alternative measures of accountability. The first measure, *regime*, focuses narrowly on the level of democratization and follows early work by Ross (2004). The variable is drawn from the Polity IV database and ranges from 0 (not at all democratic) to 10 (entirely democratic).¹⁶ The second measure, *icrgind1*, measures a broader concept of accountability and follows Mahon (2005). It is drawn from the International Country Risk Guide database and is a composite average score based on individual ICRG scores for

¹⁶ In the Polity IV database the regime variable ranges from -10 to 10, but is adjusted here in order to facilitate the interpretation of the results.

corruption, bureaucratic quality, law and order and democratization. Finally, a third measure of accountability is available from the more recent World Bank Governance Indicators dataset (*wbacc*), and while this indicator has not been employed by previous studies it is included here to test the robustness of the results.

Alongside the inherent difficulty of measuring accountability across countries, all three indicators, and particularly the final two, are heavily reliant on subjective judgments by ‘country experts’. This implies that these measures, while still valuable, are inherently imprecise, and this is reflected explicitly in the reporting of the WB indicators. Researchers have generally judged these to be acceptable limitations, and cross-country econometric work using such indicators has become increasingly common, but the lack of precision should nonetheless be borne in mind when interpreting the results (Williams and Siddique 2008). It is precisely the uncertainty associated with indicators that explains the decision to employ three alternative measures, and thus implicitly test the robustness of the results. The ICRG and WB indicators also face a more practical limitation in their data coverage. The ICRG indicators first become available in 1984 and cover only 31 countries, thus implying significant data loss, though most of the excluded values are from island and small nations. The problem is even more severe for the WB indicators, which are available for all 47 countries, but only begin in 1996. These problems are, unfortunately, unavoidable, but do mean that results using the Polity IV and ICRG indicators are given significantly greater weight in interpreting the results, owing to the very short time series available using the WB indicator.

4.4.2. Measuring Tax Reliance

The primary independent variable in the model is tax reliance, but tax reliance can be measured in several different ways. The most important question is whether tax reliance should be measured by the level of tax revenue collection as a share of GDP, or by the share of tax revenue in total government revenue.

Tax revenue as a share of total government revenue (*taxrev_tr*) reflects the concept of tax reliance most closely, and the case for relying on this variable is captured by Ross (2004)

when he argues that, “both the size of the tax burden, and the quality and quantity of government spending matter; citizens ultimately care about the ‘price’ they pay for the government services they receive. Democracy in this case is not necessarily a way for citizens to reduce their taxes, or to increase spending, but to get more for their money” (234). Following this logic, demands for accountability will be stronger in states that are reliant on tax revenue because the ‘price’ of government services is high, as they are fully financed by tax revenue. By contrast, demands for accountability will be low in countries that rely heavily on non-tax revenue, as that non-tax revenue subsidizes the cost of government services. Seen from the perspective of government, it is the level of tax reliance, rather than the absolute level of tax collection, that is likely to shape the willingness of government to make tax bargaining concessions to citizens. Quite simply, a government that has limited access to non-tax revenue is likely to have strong incentives to bargain with taxpayers owing to the simple absence of alternative revenue raising options.

Yet, while tax revenue as a share of total revenue is most consistent with the concept of tax reliance, and with the broader theoretical framework presented so far, there is still value in also testing the results using tax revenue collection as a share of GDP (*taxrev*) as the independent variable. This alternative approach is appealing because it captures the straightforward idea that when taxpayers are forced to pay more taxes to the government they are likely to correspondingly demand greater accountability, even if they are receiving high quality government services. Thus, while there is a modest preference on conceptual grounds for focusing on tax revenue as a share of total government revenue all of the results to follow are tested using both possibilities.

A final question in deciding on the independent variable is whether to rely on total tax revenue (*taxrev*) or exclusively on income tax revenue (*taxinc*). There is a long literature arguing that income taxes are likely to be particularly relevant to tax protests and tax bargaining because they are more reliant on voluntary compliance and are most explicitly visible to taxpayers (Lieberman 2002, Bates and Lien 1985, Martin and Gabay 2007). On the other hand, in developing countries indirect taxes affect a much broader segment of the population than direct taxes and are often the dominant source of government revenue. As

a consequence it seems reasonable to test both total tax revenue (*taxrev*) and income tax revenue alone (*taxinc*).

4.4.3. Other Independent Variables

In testing the impact of tax reliance on levels of accountability it is necessary to control for other factors that may shape the accountability of governments. Yet, somewhat surprisingly, existing econometric studies have uncovered relatively few variables that consistently affect levels of democratization and accountability across countries. The most robust finding from existing studies is that levels of per capita GDP are positively associated with the expansion of accountability, and all of the tests that follow correspondingly include the log of per capita GDP (*loggdp*) as a control variable.

Other studies of the determinants of democracy have suggested a variety of other variables that may influence democratization across countries, including violent conflict, religious composition, ethno-linguistic fractionalization, colonial heritage, agricultural share of employment, literacy levels, urbanization and others (Barro 1999, Clague, Gleason and Knack 2001). Nonetheless, the core results reported below do not include any of these variables, for two reasons. First, many of these variables are time invariant characteristics of individual countries, and are thus captured by the fixed-effects term of the models employed here. Second, while robustness tests were conducted including controls for conflict, literacy, agricultural share and urbanization none of these variables had a consistently statistically significant impact. While this may appear surprising at first it is, in fact, consistent with the earlier studies by both Ross (2004) and Mahon (2005).

4.5. Model Specification: Correlation and Causation

In order to test the hypothesis that states that are more reliant on taxation are more likely to be accountable to their citizens it is useful to consider two questions in turn. First, is the data consistent with the research hypothesis? Specifically, are states that are more reliant on taxation also more likely to be accountable, all else being equal? Second, is it possible to establish a causal relationship? Specifically, is there compelling evidence that tax reliance has been the cause of higher levels of accountability? Answering these two

questions in turn is useful because of the already noted difficulty of establishing causality when there is such a significant risk of endogeneity. If the research hypothesis is accurate then the cross-country data should minimally be consistent with the hypothesis, even if it is not possible to decisively establish causation.

In order to answer the first question we specify a relatively simple model in which the level of accountability is a function of a tax revenue variable, the log of per capita GDP, country-fixed effects and an error term:

$$Accountability_{it} = a + b_1*(TaxRev_{it}) + b_2*(LogGDP_{it}) + a_i + e_{it}$$

We test this model using a relatively simple OLS model with country-fixed effects and robust standard errors. While this model makes no effort to establish causation, it provides a baseline for asking whether the data conforms to the basic patterns predicted by the research hypothesis.

Establishing causation is more challenging and the econometric tests here follow earlier work by Ross (2004) and Mahon (2005). Following the methodological discussion at the beginning of this chapter, all of the results employ panel corrected standard errors (PCSEs) and correct for serial correlation either by employing Prais-Winsten or Baltagi-Wu regressions or by making use of a lagged dependent variable (LDV) model. In order to establish causation, the results here follow both Ross and Mahon in relying on the use of lagged versions of the tax revenue term as the explanatory variable. Thus the basic model becomes:

$$Accountability_{it} = a + b_1*(TaxRev_{i(t-1)}) + b_2*(LogGDP_{it}) + a_i + e_{it}$$

or, in the case of the LDV model:

$$Accountability_{it} = a + b_1*(Accountability_{i(t-1)}) + b_2*(TaxRev_{i(t-1)}) + b_3*(LogGDP_{it}) + a_i + e_{it}$$

This strategy rests on the assumption that if tax reliance is the cause of increased accountability, then changes in tax reliance should precede subsequent, and related, changes in accountability by one, three, five or ten years. Ross (2004) writes that, “it seems most sensible to me that a change in the independent variables (taxes) should precede a change in the dependent variable (regime type)” (238). Unfortunately, while this is an intuitive claim, there is little evidence to suggest that it is necessarily true, as both historical experience and the theoretical arguments presented in chapter 2 point to the possibility of more complex causal processes. The tests here nonetheless follow this approach, which appears to be the best available and, perhaps more importantly, subjects earlier (positive) results to scrutiny using a more complete and accurate dataset. We will return to concerns about model specification at the end of this chapter.

4.6.Results

Given the inherent imperfection of available econometric methods, and uncertainty about the preferred variables and model specification, what follows presents a relatively wide array of econometric tests in order to ensure the robustness of the results. The first set of results confirms that the cross-country data is minimally consistent with the research hypothesis. The more extensive second set of results finds that, contrary to previous findings, there is *not* compelling evidence of a positive causal relationship between tax reliance and levels of accountability. Instead, the results are generally inconclusive, as most results lack statistical significance and different specifications yield substantially different results.

4.6.1. Is Tax Reliance Associated With Greater Accountability?

The first set of tests asks whether tax reliance is correlated with greater accountability. These tests fall short of testing for causality, but are important in order to confirm that cross-country data is minimally consistent with the research hypothesis. The results reported in Table 4.2 are based on an OLS model with fixed effects and PCSEs, and the model is tested using three alternative measures of accountability and four alternative measures of tax reliance. The results broadly confirm that, all else being equal, tax reliance is correlated with greater accountability, as the coefficients on the revenue terms are

positive and statistically significant in seven of the twelve specification, and positive in all but one. While these results are not overwhelming, they are certainly sufficient to confirm that the cross-country data is broadly consistent with the research hypothesis, which is an important initial finding.

Table 4.2: Basic Fixed Effects with PCSEs: Contemporaneous Relationships

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	(9)	(10)	(11)	(12)
	regime	regime	regime	regime	icrgind1	icrgind1	icrgind1	icrgind1	wbacc	wbacc	wbacc	wbacc
loggdgdp	-1.591*** (0.462)	-2.477*** (0.479)	-1.482*** (0.527)	-1.951*** (0.508)	-0.023 (0.186)	-0.019 (0.192)	0.124 (0.155)	-0.018 (0.173)	0.814*** (0.257)	0.790*** (0.262)	1.057*** (0.283)	0.899*** (0.255)
taxrev	0.0026 (0.026)				0.0115 (0.008)				0.024*** (0.008)			
taxinc		0.241*** (0.069)				0.033 (0.028)				0.039 (0.024)		
taxrev_tr			0.952* (0.571)				-0.150 (0.161)				0.360*** (0.117)	
taxinc_tr				5.777*** (1.270)				0.971** (0.470)				0.832*** (0.283)
Constant	7.860*** (1.368)	9.941*** (1.355)	7.412*** (1.546)	8.624*** (1.445)	2.249*** (0.507)	2.255*** (0.527)	1.937*** (0.450)	2.265*** (0.489)	-3.828*** (0.744)	-3.681*** (0.747)	-4.417*** (0.826)	-3.950*** (0.734)
Obs.	1,073	1,071	1,075	1,070	552	551	552	551	303	301	303	301
R ²	0.453	0.464	0.455	0.464	0.633	0.634	0.632	0.635	0.895	0.893	0.892	0.893
No. of id	42	42	42	42	29	29	29	29	45	45	45	45

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

4.6.2. Does Tax Reliance Cause Greater Accountability?

Having confirmed that the cross-country data is broadly consistent with the research hypothesis we now turn to efforts to explicitly test causality. Tables 4.3 through 4.9 report a wide range of results from the most econometrically robust specifications, relying on three-year lags on the tax variables unless otherwise noted. These represent only a subset of the total tests that have been run, but provide a relatively thorough and representative sense of the results

Tables 4.3 and 4.4 report the results of a fixed effects model using PCSEs and a Prais-Winsten correction for serial correlation. Table 4.3 reports results using each of the four hypothesized revenue variables, with three year lags, alongside all three political variables. Table 4.4 focuses exclusively on the tax revenue share variable, testing results using zero, one, three and five years lags in order to explore the sensitivity of the results to different lag structures. Tables 4.5 and 4.6 are a mirror image of Tables 4.3 and 4.4, with the exception that they rely on the Baltagi-Wu correction for serial correlation and, consequently, do not include the use of PCSEs. Tables 4.7 and 4.8 again adopt the same basic pattern, but

employ a simple LDV model with fixed-effects and PCSEs. The results using the World Bank accountability variable are dropped because the available time series is insufficiently long when employing an LDV model. Finally, Table 4.9 employs a dynamic Arellano-Bond model using a three-year lag, and the results using the WB accountability variable are again dropped.

Table 4.3: Fixed Effects with PCSEs and AR(1) Correction: All Variables Using 3-Year Lags

	(1) regime	(2) regime	(3) regime	(4) regime	(5) icrgind1	(6) icrgind1	(7) icrgind1	(8) icrgind1	(9) wbacc	(10) wbacc	(11) wbacc	(12) wbacc
loggdp	-0.236 (0.763)	-0.267 (0.772)	-0.085 (0.789)	-0.325 (0.756)	0.482 (0.335)	0.501 (0.333)	0.475 (0.340)	0.474 (0.339)	1.005*** (0.327)	0.917*** (0.303)	0.987*** (0.316)	0.916*** (0.309)
L3.taxrev	-0.007 (0.016)				-0.002 (0.007)				0.009 (0.009)			
L3.taxinc		0.048 (0.042)				-0.008 (0.018)				-0.017 (0.024)		
L3.taxrev_tr			-0.006 (0.443)				-0.047 (0.148)				0.154 (0.165)	
L3.taxinc_tr				0.844 (0.918)				-0.045 (0.344)				-0.268 (0.309)
Constant	4.345** (2.188)	4.315* (2.212)	3.863* (2.275)	4.520** (2.162)	0.959 (0.977)	0.905 (0.971)	0.974 (0.989)	0.971 (0.986)	-4.281*** (0.968)	-3.958*** (0.870)	-4.200*** (0.916)	-3.966*** (0.887)
Obs.	966	964	968	963	535	535	535	535	304	303	304	303
R ²	0.109	0.101	0.079	0.123	0.473	0.473	0.471	0.473	0.882	0.881	0.881	0.881
No. of id	42	42	42	42	29	29	29	29	45	45	45	45

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Table 4.4: Fixed Effects with PCSEs and AR(1) Correction: Tax Revenue Share Using all Lag Structures

	(1) regime	(2) regime	(3) regime	(4) regime	(5) icrgind1	(6) icrgind1	(7) icrgind1	(8) icrgind1	(9) wbacc	(10) wbacc	(11) wbacc	(12) wbacc
loggdp	-0.444 (0.776)	-0.220 (0.827)	-0.0855 (0.789)	-0.149 (0.821)	0.336 (0.335)	0.298 (0.353)	0.475 (0.340)	0.577** (0.288)	0.953*** (0.321)	0.939*** (0.348)	0.987*** (0.316)	1.269*** (0.376)
taxrev_tr	0.0750 (0.400)				0.0216 (0.142)				0.308** (0.121)			
L.taxrev_tr		0.304 (0.411)				-0.147 (0.145)				0.0467 (0.203)		
L3.taxrev_tr			- 0.00591 (0.443)				-0.0467 (0.148)				0.154 (0.165)	
L5.taxrev_tr				-0.607 (0.489)				-0.163 (0.161)				0.104 (0.145)
Constant	4.523** (2.250)	3.956* (2.398)	3.863* (2.275)	4.251* (2.390)	1.214 (0.963)	1.379 (1.020)	0.974 (0.989)	0.534 (0.827)	-4.133*** (0.930)	-4.046*** (1.020)	-4.200*** (0.916)	-4.977*** (1.081)
Obs.	1,075	1,041	968	894	552	547	535	523	303	309	304	294
R ²	0.094	0.067	0.079	0.136	0.452	0.463	0.471	0.520	0.878	0.875	0.881	0.886
No. of id	42	42	42	42	29	29	29	29	45	45	45	44

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Table 4.5: Fixed-Effects with Baltagi-Wu AR(1) Correction: All Variables Using a 3 Year Lag

	(1) regime	(2) regime	(3) regime	(4) regime	(5) icrgind1	(6) icrgind1	(7) icrgind1	(8) icrgind1	(9) wbacc	(10) wbacc	(11) wbacc	(12) wbacc
loggdp	1.600** (0.629)	1.680*** (0.644)	1.701*** (0.645)	1.682*** (0.642)	1.097*** (0.206)	1.098*** (0.206)	1.097*** (0.206)	1.099*** (0.206)	-0.480*** (0.182)	-0.480*** (0.176)	-0.489*** (0.186)	-0.486*** (0.178)
L3.taxrev	-0.003 (0.0163)				-0.004 (0.006)				-0.006 (0.008)			
L3.taxinc		0.038 (0.045)				-0.009 (0.015)				-0.039** (0.0191)		
L3.taxrev_tr			0.148 (0.442)				-0.003 (0.145)				-0.042 (0.138)	
L3.taxinc_tr				0.575 (0.916)				-0.129 (0.296)				-0.402 (0.311)
Constant	0.860*** (0.168)	0.455*** (0.171)	0.430** (0.172)	0.480*** (0.170)	-0.322*** (0.081)	-0.342*** (0.079)	-0.370*** (0.081)	-0.353*** (0.081)	0.966*** (0.066)	1.080*** (0.065)	0.942*** (0.066)	1.003*** (0.066)
Obs.	924	922	926	921	506	506	506	506	259	258	259	258
No. of id	42	42	42	42	29	29	29	29	45	45	45	45

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Table 4.6: Fixed-Effects with Baltagi-Wu AR(1) Correction: Tax Revenue Share Using Different Lag Structures

	(1) regime	(2) regime	(3) regime	(4) regime	(5) icrgind1	(6) icrgind1	(7) icrgind1	(8) icrgind1	(9) wbacc	(10) wbacc	(11) wbacc	(12) wbacc
loggdp	0.449 (0.654)	0.621 (0.647)	1.701*** (0.645)	2.141*** (0.639)	1.474*** (0.304)	1.535*** (0.291)	1.097*** (0.206)	1.018*** (0.167)	-0.593*** (0.187)	-0.535*** (0.187)	-0.489*** (0.186)	-0.436*** (0.165)
taxrev_tr	0.165 (0.414)				0.075 (0.138)				0.078 (0.165)			
L.taxrev_tr		0.421 (0.421)				-0.069 (0.138)				-0.174 (0.156)		
L3.taxrev_tr			0.148 (0.442)				-0.003 (0.145)				-0.042 (0.138)	
L5.taxrev_tr				-0.234 (0.493)				-0.067 (0.156)				-0.068 (0.139)
Constant	3.431*** (0.178)	2.891*** (0.179)	0.430** (0.172)	-0.377** (0.180)	-1.372*** (0.115)	-1.428*** (0.112)	-0.370*** (0.081)	-0.102 (0.071)	1.168*** (0.067)	1.197*** (0.065)	0.942*** (0.066)	0.793*** (0.066)
Obs.	1,033	999	926	852	523	518	506	494	258	264	259	250
No. of id	42	42	42	42	29	29	29	29	45	45	45	44

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Table 4.7: Lagged Dependent Variable with PCSEs and Fixed-Effects: All Variables Using a 3 Year Lag

	(1) regime	(2) regime	(3) regime	(4) regime	(5) icrgindl	(6) icrgindl	(7) icrgindl	(8) icrgindl
loggdp	-0.443 (0.443)	-0.775* (0.431)	-0.743 (0.473)	-0.713 (0.445)	0.404* (0.230)	0.477** (0.225)	0.369* (0.220)	0.442** (0.218)
L3.regime	0.692*** (0.072)	0.701*** (0.071)	0.698*** (0.071)	0.699*** (0.071)				
L3.icrgindl					0.449*** (0.089)	0.457*** (0.089)	0.446*** (0.088)	0.458*** (0.089)
L3.wbacc								
L3.taxrev	-0.033* (0.019)				-0.011 (0.007)			
L3.taxinc		0.042 (0.049)				-0.058** (0.025)		
L3.taxrev_tr			-0.845* (0.489)				- 0.439*** (0.163)	
L3.taxinc_tr				1.445 (1.147)				-1.004** (0.447)
Constant	2.887** (1.331)	3.549*** (1.277)	3.656** (1.448)	3.387** (1.327)	0.174 (0.649)	-0.0298 (0.638)	0.279 (0.620)	0.0173 (0.610)
Obs.	962	961	964	960	469	469	469	469
R ²	0.703	0.706	0.704	0.706	0.739	0.743	0.741	0.742
No. of id	42	42	42	42	29	29	29	29

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Table 4.8: Lagged Dependent Variable with PCSEs and Fixed-Effects: Tax Revenue Share Using Different Lag Structures

	(1) regime	(2) regime	(3) regime	(4) icrgindl	(5) icrgindl	(6) icrgindl
loggdp	-0.278 (0.242)	-0.743 (0.473)	-0.699 (0.504)	0.093 (0.126)	0.369* (0.220)	0.691*** (0.229)
L.regime	0.906*** (0.028)					
L3.regime		0.698*** (0.071)				
L5.regime			0.550*** (0.099)			
L.icrgindl				0.817*** (0.042)		
L3.icrgindl					0.446*** (0.088)	
L5.icrgindl						0.107 (0.096)
L.taxrev_tr	-0.0894 (0.288)			-0.242*** (0.0938)		
L3.taxrev_tr		-0.845* (0.489)			-0.439*** (0.163)	
L5.taxrev_tr			-1.449** (0.604)			-0.430** (0.202)
Constant	1.262* (0.722)	3.656** (1.448)	4.228*** (1.630)	0.192 (0.368)	0.279 (0.620)	0.046 (0.683)
Obs.	1,039	964	888	525	469	412
R ²	0.895	0.704	0.617	0.899	0.741	0.706
No. of id	42	42	42	29	29	29

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Table 4.9: Arellano-Bond Lagged Dependent Variables Model: All Variables Using a 3 Year Lag

	(1) regime	(2) regime	(3) regime	(4) regime	(5) icrgind1	(6) icrgind1	(7) icrgind1	(8) icrgind1
L.regime	0.971*** (0.024)	0.974*** (0.024)	0.970*** (0.025)	0.975*** (0.025)				
L2.regime	-0.137*** (0.044)	-0.141*** (0.044)	-0.138*** (0.045)	-0.142*** (0.045)				
L3.regime	0.012 (0.025)	0.012 (0.026)	0.0165 (0.026)	0.014 (0.027)				
L.icrgind1					1.035*** (0.054)	1.031*** (0.056)	1.034*** (0.053)	1.036*** (0.054)
L2.icrgind1					-0.305*** (0.042)	-0.302*** (0.041)	-0.310*** (0.04)	-0.308*** (0.041)
L3.icrgind1					0.018 (0.032)	0.0188 (0.031)	0.02 (0.032)	0.019 (0.031)
loggdp	-0.042 (0.606)	-0.112 (0.608)	-0.166 (0.718)	-0.052 (0.679)	0.138 (0.319)	0.154 (0.331)	0.091 (0.322)	0.117 (0.327)
L3.taxrev	0.007 (0.018)				-0.006 (0.004)			
L3.taxinc		0.035 (0.039)				-0.017 (0.015)		
L3.taxrev_tr			-0.453 (0.572)				-0.146 (0.136)	
L3.taxinc_tr				0.127 (0.959)				-0.085 (0.259)
Constant	0.684 (1.676)	0.841 (1.609)	1.447 (2.007)	0.785 (1.771)	0.324 (0.824)	0.265 (0.831)	0.481 (0.834)	0.319 (0.824)
Obs.	904	903	906	901	436	436	436	436
No. of id	42	42	42	42	29	29	29	29

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

The results using fixed effects models with corrections for serial correlation, reported in Tables 4.3 through 4.6, are almost universally statistically insignificant. The insignificance of the results is, moreover, entirely insensitive to changes in the length of the lag or to changes in the particular political and revenue variables employed. This suggests clearly that changes in taxation do not consistently precede corresponding changes in accountability, in contrast to the findings of previous studies.

The LDV specifications present even more surprising results. In almost half of the basic LDV specifications reported in Tables 4.7 and 4.8 the results are *negative* and statistically significant. Not only does this finding directly contradict the research hypothesis, it is at odds with the finding that contemporaneous values of the taxation and accountability variables are positively correlated. In simplest terms, it is logically impossible for increased tax reliance to be a cause of declining accountability *and* for high levels of taxation and accountability to be positively correlated. Indeed, a negative relationship

between taxation and accountability is logically problematic on its own merits, as it implies that improvements in tax collection will lead to dictatorship and, more illogically, that improvements in accountability will erode the fiscal base of the state. These suggestions are, moreover, totally at odds with the observed experience of the large number of high accountability, high taxation states in the world.

The concerns raised by these results are alleviated to some degree by the model reported in Table 4.9, which again finds no statistically significant relationship in any of the model specifications. Given that the Arellano-Bond model is generally held to be more robust than the simpler model implemented in Tables 4.7 and 4.8, the overall message appears to simply be that there is no statistically significant, positive, cross-country relationship between increased tax reliance in one period and increased accountability in subsequent years. In addition, the seeming implausibility of the results from the simple LDV model argues for taking a closer look at questions of data and model specification in order to better understand the econometric outcome.

4.7. Interpretation

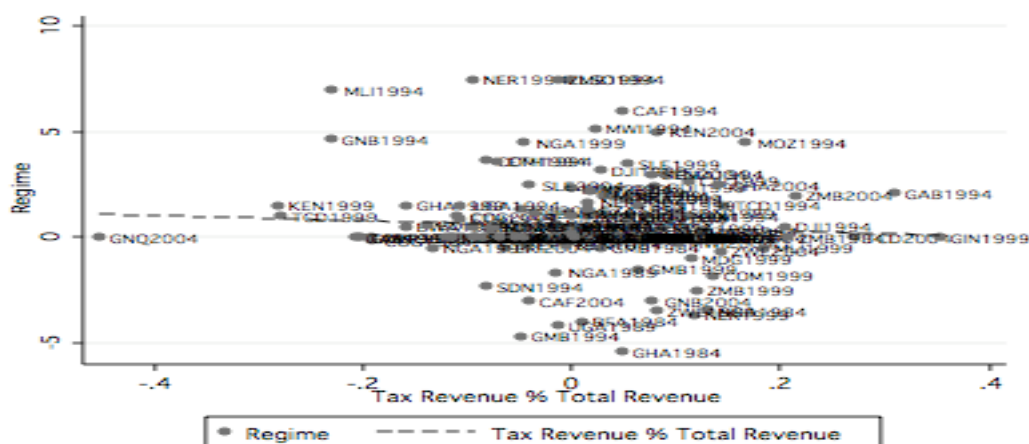
While earlier studies have reported a positive causal relationship between tax reliance and accountability, this study has failed to find any consistently significant relationship, while employing much improved data and more robust econometric methods. This may mean one of two things. The first possibility is that increased tax reliance simply is not a consistent catalyst for broader improvements in accountability. The alternative possibility is that there are underlying limitations in the data or with the econometric model, which prevents it from capturing the positive impact of tax reliance on accountability. In practice, there is good reason to believe that the highly inconclusive econometric results are, in fact, a reflection of such underlying limitations.

4.7.1. Underlying Data Problems

In order to better understand the highly inconclusive, and sometimes negative, econometric results, it is instructive to return to a more descriptive and intuitive view of the underlying data. Figure 4.1 presents a graphical representation of the key relationship reflected in the

results, plotting changes over a five-year period in the share of taxation in total revenue on the horizontal axis, and changes in the level of democratization over the subsequent five-year period on the vertical axis. This mimics the basic causal model tested earlier, as changes in tax reliance in one period are expected to generate corresponding changes in accountability in the subsequent period. Positive results, in the econometric sense, are those that fall in the top-right quadrant, representing increased tax reliance and increased accountability, and those in the bottom-left quadrant, representing decreased tax reliance and correspondingly decreased accountability.

Figure 4.1: Impact of Changes in Tax Revenue Share on Subsequent Changes in Regime Type



What is immediately clear from Figure 4.1 is that while the largest number of results falls in the top-right quadrant, as the tax-accountability hypothesis would predict, virtually no results fall in the bottom left quadrant. The absence of outcomes in the bottom left quadrant could account for the overall weakness of the econometric results, as a positive result is highly unlikely with such a distribution of outcomes. This pattern of a large number of observations in the top-right quadrant and very few in the bottom left quadrant is repeated across the different model specifications employed here.

Most importantly, the absence of outcomes in the bottom-left quadrant appears to be largely an artefact of limited data, rather than a strict empirical reality. The research hypothesis is based on the assumption that highly tax reliant countries will be more accountable, while countries with access to significant non-tax revenue will be less accountable. Yet, while

sub-Saharan Africa contains many countries that fit the latter description, experiencing low levels of both tax reliance and accountability, in most cases the dependence of those countries on resource revenue *pre-dates* the availability of time-series revenue data.¹⁷

Because the preceding econometric tests necessarily rely on fixed-effects models, which focus on within country variation over time, these cases of declining tax revenue and declining accountability are simply not captured due to the absence of historical data. To take one particularly relevant example, the first well-known study to consider the connection between taxation and accountability in an African context was Jane Guyer's (1992) work documenting the declining accountability of the government in Nigeria after the discovery of oil. She attributes declining accountability in Nigeria to falling levels of taxation, but this case pre-dates data availability, and thus cannot be captured by the econometric results reported here. The only case of a major decline in tax reliance that *is* captured by available data is Equatorial Guinea, but in that case the level of accountability was so low even before the discovery of oil that no further change was possible.

Of course, none of this constitutes positive evidence of a strong, causal, cross-country relationship between tax reliance and accountability. What it does do is provide a credible empirical explanation for the absence of compelling econometric results, and thus provides a basis for the belief that the weakness of the econometric results does not necessarily imply the absence of a relationship in practice.

4.7.2. Problems of Model Specification

A more interesting explanation for the absence of compelling econometric results surrounds the question of model specification. The econometric results reported here test a very specific causal model, in which increases in taxation in one period are followed by increased accountability one, three or five years later. This strict temporal structure follows widely cited earlier work and is adopted in an effort to establish causality, but it represents

¹⁷ In the first year for which data is available for Nigeria, 1973-74, tax revenues comprised only 26% of total revenue. In Angola only 12.4% of revenue came from domestic tax revenue in the first year for which data is available. In Guinea tax revenue was 15% of total revenue in the first year for which data is available, while in Gabon the figure is 55%, and has remained reasonably stable over time.

a very strong assumption about the character of the tax bargaining process. As noted earlier, both historical evidence and theory provide significant grounds to suspect that this assumption is, in fact, problematic.

The implicit model of tax bargaining that lies behind the econometric results proceeds as follows. First, the government takes a fiscal action, such as introducing a new tax or expanding enforcement of an existing tax. Second, taxpayers respond politically to this new tax. Third, the government is forced to bargain with taxpayers and is eventually forced to expand accountability. In this simple narrative an increase in tax revenue does, indeed, precede the expansion of accountability.

Yet, in reality, tax bargaining is equally likely to follow alternative pathways that would not be captured by the simple econometric model employed by this and earlier studies. In one scenario the government, anticipating public resistance to new taxation, may make *pre-emptive* concessions to taxpayers in order to smooth implementation of new taxation. In this case accountability precedes the expansion of taxation, and the econometric model would fail to capture the connection between tax reliance and accountability. In a second scenario, taxpayers, unsatisfied with government performance, may resist existing taxation and thus force the government to expand accountability in order to restore tax collection. In this case not only does increased taxation not precede increased accountability, increased accountability is actually preceded by *reduced taxation*, which would yield *negative* econometric results. Finally, in a third scenario government may seek to introduce new taxation but be prevented from doing so by public opposition which, thus mobilized, also demands the expansion of accountability. This is, again, a clear case of tax bargaining, but accountability is expanded without any actual change in tax revenue, thus making such an episode invisible to econometric analysis.

There are thus very good reasons to believe that the econometric model employed here, and by earlier studies, will simply be unable to capture the complex dynamics linking tax reliance to the expansion of accountability. While this possibility has been presented in largely theoretical terms here, it finds compelling empirical support in the case studies to

follow. Tax bargaining only occasionally follows a simple pattern in which increased taxation leads to tax bargaining and the expansion of accountability, and just as frequently conforms to the alternative scenarios presented here.

4.8. Conclusions

This chapter has taken a fresh look at earlier cross-country econometric studies of the relationship between tax reliance and accountability. Drawing on a dramatically improved data set it has demonstrated that cross-country data is broadly consistent with the claim that governments that are more reliant on tax revenue are more likely to be accountable to their citizens, but that, contrary to earlier studies, there is no compelling evidence of the existence of a causal relationship. It has gone on to argue that this is not necessarily evidence of the absence of a causal relationship in practice, as the weakness of the results can be credibly explained by underlying data problems and, most tellingly, by problems with model specification. The ultimate message of the results is that *if* there is a causal relationship between tax reliance and accountability then it is likely to operate through a relatively complex set of causal processes rather than the simple linear formulation embodied in existing econometric models. This, in turn, argues for the need for alternative, and more nuanced, research strategies.

While this chapter reflects an implicit scepticism about the potential for cross-country econometric models to effectively capture complex and contingent causal processes, there is nonetheless almost certainly scope for creative econometric approaches to addressing the relationship between tax reliance and accountability. This is likely to be particularly true at the sub-national, firm and individual levels as the quality of available data improves. That said, this chapter has emphasized the potential pitfalls of pursuing econometric tests in the absence of a clear theoretical and empirical understanding of the causal processes at work. Such knowledge remains all too limited with respect to the relationship between tax reliance and accountability. As such, there is a pressing need to gain a much clearer understanding of the particular causal processes at work at the country level, and this is best achieved through detailed case studies. The next chapter correspondingly presents the methodology that has been employed in identifying three case study countries for this

thesis, and situates the three case studies within the broader context of experiences in sub-Saharan Africa. This sets the stage for the presentation of the case study evidence in the chapters to follow.

5. Case Selection: Tax Effort, Foreign Aid and Levels of Development

The previous chapter argued the need for case study research to further our understanding of the relationship between tax reliance and the expansion of responsiveness and accountability. Of course, the weakness of case study evidence lies in the risk that findings will be idiosyncratic and country specific, and thus fail to be more broadly relevant. Careful case selection is essential. The goal of this chapter is to describe the case selection process in detail while contextualizing the case study countries relative to other countries in the region, in order to better define the scope of the research.

The chapter begins by undertaking a cross-country econometric investigation of the tax collection performance of sub-Saharan African countries. This information is used to both inform the case selection process and place the cases that are selected in broader context. Conventionally known as a ‘tax effort’ analysis, the econometric analysis captures levels of tax collection in each country over time relative to expected levels of collection. These expected levels of collection are, in turn, based on a series of factors that are expected to shape tax collection, including per capita income and levels of international trade. In essence, the analysis provides a clearer picture of the effectiveness of tax collection both across countries and within countries over time, by controlling for structural economic factors that are likely to lead to differing levels of tax collection.

In addition to providing insight into tax performance, the econometric analysis also sheds light on the relationship between foreign aid and levels of tax collection. Various recent studies have argued that access to foreign aid may have consistently eroded incentives for domestic tax collection in developing countries (Gupta et al. 2004, Moss, Pettersson and van de Walle 2006). If true, this would have important implications for both case selection and our broader understanding of tax behaviour, and tax bargaining, in aid-dependent countries. As such, this question is given special attention here, as well as in Chapter 11, which focuses explicitly on the impact of aid on taxation and tax bargaining.

5.1. Estimating Tax Effort

In practical terms, the estimation of ‘tax effort’ involves estimating the impact of various exogenous factors on levels of tax collection across countries. While such studies are relatively common, they encounter many of the same econometric and data challenges described in the previous chapter. The unique contribution of the analysis presented here lies in addressing a long-standing econometric question using significantly improved data.

The long history of tax effort studies is ably reviewed elsewhere, and does not demand extensive discussion here beyond highlighting the key results (Gupta 2007). The most robust findings from existing studies are that tax revenues increase with GDP per capita and with the share of trade in the economy, while tax revenue declines when the agricultural share is higher and when governments have access to large non-tax revenues. Trade increases revenue because it is taxed directly and because trade is generally indicative of greater formalization of economic activity. By contrast, agriculture is notoriously difficult to tax because of low incomes, low levels of monetization, the difficulty of tracking transactions and political resistance. The fact that tax revenue collection as a share of GDP increases with income is somewhat less clear-cut, but is generally held to reflect the greater sophistication and formalization of higher income economies, which, in turn, tends to facilitate taxation. It is also possible that high income may act as a proxy for greater government administrative capacity. Finally, non-tax revenue is associated with reduced tax collection because such revenue reduces the need for politically contentious taxation.

Different studies have included myriad other possible explanatory variables, but none has proven to be consistently significant. These have included measures of debt reliance, corruption, economic structure, human capital development and institutional quality, among others. The most contentious debate has centred on the impact of foreign aid on domestic tax collection. Several authors have proposed that access to foreign aid may reduce tax effort by providing a fungible form of foreign exchange that can act as a substitute for domestic tax revenue. These authors have thus proposed that foreign aid is likely to influence tax collection much like any other source of non-tax revenue. However, while this argument has a compelling logic, other authors have pointed out that foreign aid is very

different from other forms of non-tax revenue and may thus have very different effects. In broad terms, foreign aid is frequently accompanied by donor conditionality and technical assistance, both of which may lead to higher, rather than lower, levels of tax effort (Collier 2006).

This debate is reflected in conflicting findings among existing econometric studies. Among the most cited studies is that of Gupta et al. (2004), which reports that increased foreign aid has led to reduced levels of domestic tax collection across the developing world. More strikingly, the authors argue that when aid is disaggregated into grant and loan components, grants have discouraged revenue performance while loans have not, presumably because loans need to be repaid. The finding that total foreign aid reduces tax collection is echoed by several other studies, (Mahdavi 2008, Remmer 2004, Gupta et al. 2005, Devarajan, Rajkumar and Swaroop 1999, Brautigam and Knack 2004) while a more recent study has reported a negative relationship between foreign aid and the quality of tax administration, as reported by World Bank staff (Knack 2009). While this evidence is not insignificant, these studies all suffer from the data problems raised in the previous chapter, while there are also two additional reasons for caution in interpreting the results. First, the finding of a differential impact of loans and grants on levels of tax collection does not appear to have been replicated in any of these studies. Second, despite the prevailing view that foreign aid has a negative impact on tax collection, several recent studies, which have relied on improved data and more careful econometric strategies, have found the opposite (Gupta 2007, Brun, Chambas and Guerineau 2008). Most striking is recent work by Clist and Morrissey (2010) which finds that foreign aid has, in fact, had a positive impact on levels of tax collection over the past two decades, most likely reflecting greater donor attention to domestic tax performance.

5.1.1. Model and Results

Given that tax effort studies are relatively ubiquitous, the analysis presented here has two relatively modest ambitions. First, to specifically address the uncertainty related to the impact of foreign aid on levels of domestic tax collection. Second, to draw on the improved

data set compiled for this study to produce a robust set of tax effort scores that can be used to inform case selection and contextualize the case studies to follow.

Given these very specific ambitions the econometric approach follows well-established practices. The analysis relies on total tax collection (as opposed to any individual tax types), and focuses on those independent variables that have been consistently significant in a large proportion of previous studies. Each regression correspondingly includes either the log of GDP or the agricultural share of GDP as an independent variable. The two are not included together, as they are strongly correlated with one another (Gupta 2007). Also included are a trade share variable and a variable for total non-tax revenue, excluding grants. The inclusion of the non-tax variable is made possible by the data cleaning exercise described in the previous chapter, and thus differs from earlier studies, which have tended to rely on highly imperfect proxies such as the mining share of GDP. Finally, all of the regressions include foreign aid variables, either as total Official Development Assistance (ODA) or disaggregated into loans and grants. Thus the basic model is as follows:

$$TaxRev_{it} = a + b_1*(logGDP_{it}) + b_2*(trade_{it}) + b_3*(non-tax_{it}) + b_4*(aid_{it}) + e_{it}$$

Table 5.1 presents the basic battery of results, with each econometric specification tested alternately using log GDP and agricultural share as explanatory variables. The first two columns present the results using a simple OLS regression with panel-corrected standard errors (PCSEs). Columns 3 and 4 present a fixed-effects model with PCSEs, while columns 5 and 6 add to that model with a correction for first order serial correlation. Finally, columns 7 and 8 use the same econometric strategy, but employ lagged versions of the aid variables, based on the possibility that the impact of aid may require a year to take effect. Building on this first set of results, Table 5.2 presents the core results when a dynamic model is employed, with columns 1 and 2 reporting the results of a simple lagged dependent variable model, and columns 3 and 4 reporting results using the Arellano-Bond general method of moments procedure.

In order to ensure the robustness of the results, all of the tests were also conducted using the import share of GDP, instead of the total trade share, but the overall impact on the results was very small. Tests were likewise conducted using alternative control variables, including political indicators, debt share, manufacturing share and the annual growth rate of GDP. As with previous studies none of these variables were consistently significant or meaningfully altered the primary results. These additional tests are thus not reported here, as our primary interest is in the aid variables and in specifying a robust baseline model to support the case selection process.

Table 5.1: Tax Effort Results Using Fixed-Effects, PCSEs and AR(1) Correction

	(1) taxrev OLS	(2) Taxrev OLS	(3) taxrev FE	(4) taxrev FE	(5) taxrev FE, AR(1)	(6) taxrev FE, AR(1)	(7) taxrev FE, AR(1)	(8) taxrev FE, AR(1)
loggdp	3.784*** (0.578)		7.970*** (1.145)		8.318*** (1.712)		8.419*** (1.629)	
agri		-0.139*** (0.0138)		-0.151*** (0.015)		-0.099*** (0.018)		-0.101*** (0.018)
tradesh	0.109*** (0.005)	0.103*** (0.00507)	0.036*** (0.008)	0.025*** (0.008)	0.021** (0.008)	0.016* (0.008)	0.0225*** (0.008)	0.0162** (0.008)
nontax	-0.324*** (0.024)	-0.352*** (0.0242)	-0.138*** (0.031)	-0.156*** (0.031)	-0.056** (0.028)	-0.063** (0.028)	-0.0263** (0.012)	-0.026** (0.011)
grantsgni	-0.045*** (0.015)	-0.0625*** (0.0138)	0.025** (0.011)	0.007 (0.011)	0.011 (0.009)	-0.000 (0.009)		
loansgni	-0.04 (0.051)	-0.0556 (0.0490)	0.013 (0.022)	0.005 (0.021)	-0.012 (0.018)	-0.029 (0.018)		
L.grantsgni							0.015* (0.009)	0.009 (0.009)
L.loansgni							0.046** (0.017)	0.047*** (0.018)
Constant	-1.083 (1.368)	13.89*** (0.737)	-16.58*** (3.393)	9.495*** (1.415)	-18.26*** (5.115)	6.937*** (1.747)	-19.91*** (4.942)	5.509*** (1.59)
Obs.	1,065	1,066	1,065	1,066	1,065	1,066	1,089	1,089
R2	0.471	0.497	0.830	0.836	0.670	0.676	0.671	0.676
No. of id			45	45	45	45	45	45

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

Table 5.2: Tax Effort Results Using a Dynamic Estimator

	(1) taxrev LDV	(2) taxrev LDV	(3) taxrev GMM	(4) taxrev GMM
L.taxrev	0.745*** (0.033)	0.739*** (0.034)	0.530*** (0.034)	0.522*** (0.034)
loggdp	1.227 (0.867)		2.344 (1.504)	
agri		-0.026** (0.012)		-0.0423** (0.017)
tradesh	0.0199*** (0.005)	0.0180*** (0.005)	0.0194*** (0.006)	0.0176*** (0.006)
nontax	-0.033* (0.019)	-0.037* (0.019)	-0.055** (0.026)	-0.063** (0.027)
grantsgni	0.004 (0.007)	0.002 (0.007)	0.0127 (0.011)	0.009 (0.009)
loansgni	0.012 (0.015)	0.011 (0.015)	-0.002 (0.026)	-0.008 (0.025)
Constant	-3.263 (2.588)	0.912 (0.948)	-0.559 (3.843)	7.171*** (0.952)
Obs.	1014	1014	943	943
No. of id	45	45	45	45

Standard errors in parentheses

*** p<0.01, ** p<0.05, * p<0.1

The basic results are largely as expected based on previous studies. Agricultural share has a consistently negative impact on revenue collection, GDP per capita has a consistently positive impact and tax revenue increases with the trade share. As expected, the non-tax revenue variable is consistently negative and significant, thus validating the careful construction of this variable in the new dataset employed here, as the use of proxies for resource dependence has often yielded much weaker results (i.e. Knack 2009).

5.1.2. Foreign Aid and Tax Effort: Reassessing the Evidence

The most interesting results relate to the impact of foreign aid on tax revenue. The basic pooled OLS regressions yield the conventional result that greater aid is associated with lower levels of tax collection. Yet this methodology tells us only that countries with low levels of tax collection also tend to have high levels of aid, rather than saying anything about causality. It may be that aid causes low tax collection, but it may also be that countries with low levels of tax collection need, and receive, more aid over time.

When we turn to the fixed-effects and LDV estimators, which focus on the relationship between aid and taxation within countries over time, we find quite decisively that the

relationship between aid and taxation has been either negligible or positive, suggesting that, if anything, higher aid has encouraged improved revenue performance. There is, moreover, no evidence that loans have had a more positive impact on tax collection incentives than grants, contrary to earlier claims. These findings are based on testing two slightly different causal models, reflecting uncertainty about the timeline over which aid may shape tax effort. The first assumes that higher levels of foreign aid will lead to reduced levels of tax collection in the same year, and using this model the results are generally statistically insignificant. The second model employs a lagged version of the aid variable, thus assuming that higher levels of foreign aid will lead to reduced levels of tax collection in the *subsequent year*, reflecting the possibility that technical assistance and conditionality may take time to affect tax collection decisions. When this model is employed the impact of aid on taxation is consistently positive and significant. It is, of course, possible that aid may shape tax effort over an even longer time horizon, but robustness tests using longer lags revealed similar results to those reported here.

While these results are not strong enough to argue that there is a consistently positive relationship between aid and tax revenue collection, they do argue strongly against the common claim that aid consistently leads to reduced domestic tax collection. For the sake of illustration, this ambiguity is readily apparent in looking at country level tax and foreign aid data from the three case study countries (Figures 5.1 through 5.3). In Ghana, a cursory look at the data is strongly indicative of a positive relationship between aid and taxation, as aid as a share of GDP has increased steadily since the late 1970s, as has tax revenue. By contrast, both Kenya and Ethiopia present more ambiguous patterns. In Ethiopia, there appears to have been a mild correlation between higher levels of aid and lower levels of tax collection from 1993-2001, but this trend was reversed from 2002-2004, as unprecedented high levels of aid were accompanied by significant revenue growth. Finally, in Kenya there is no discernible relationship between aid and taxation in macro level data. The message here is not necessarily that aid does not affect tax collection, but simply that country level evidence is not at all consistent with the existence of a simple linear relationship between increased aid and lower tax collection.

Figure 5.1: Tax Effort and Foreign Aid in Ghana 1972-2004

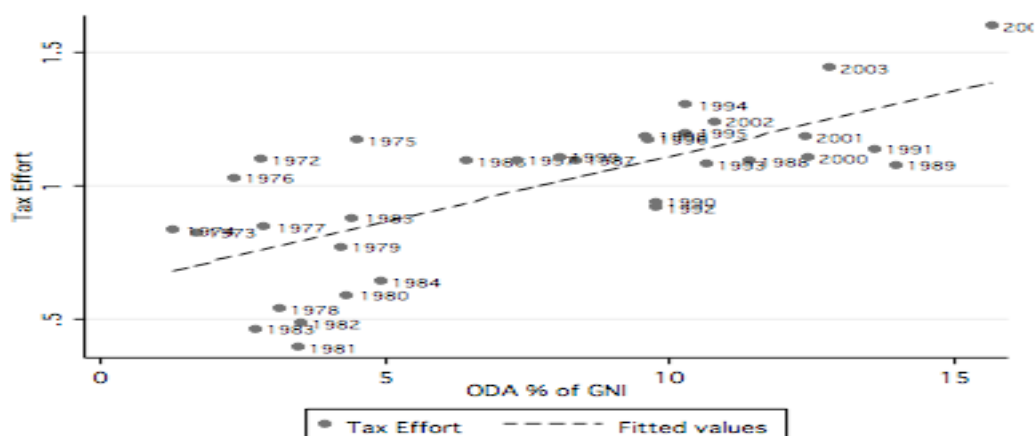


Figure 5.2: Tax Effort and Foreign Aid in Ethiopia 1981-2004

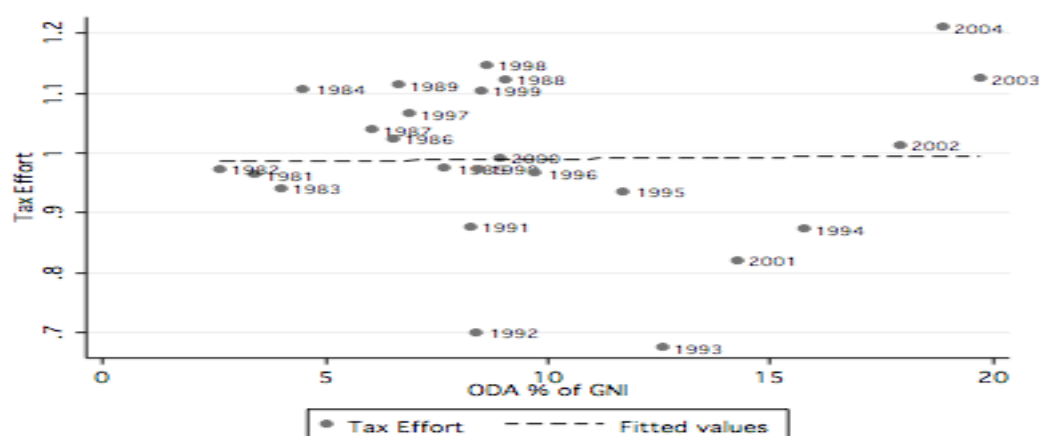


Figure 5.3: Tax Effort and Foreign Aid in Kenya 1972-2004



Despite the fact that this conclusion is inconsistent with much accepted wisdom, the results reported here are intuitively appealing. While access to aid undoubtedly creates disincentives to tax collection under some circumstance, it may also contribute to strengthened domestic tax collection in at least three ways that have frequently been overlooked by earlier studies. First, aid is often accompanied by technical assistance aimed at strengthening tax collection, and there is significant research suggesting that these efforts have been effective in at least some contexts (Fjeldstad and Moore 2008, Sanchez 2006). Second, aid has increasingly been accompanied by conditionality explicitly focused on revenue performance, with donors demanding consistent or increased levels of tax collection in exchange for aid disbursements (Fjeldstad 2001). Third, aid is also frequently accompanied by broad demands from donors for increased social spending, and this may generate indirect pressure for the expansion of public revenue collection. This is reflected in concerns about the sustainability of large increases in aid funding, as large expenditure commitments taken on by governments with external support are likely to create long-term fiscal pressures when external support declines (Moss and Subramanian 2005).

Overall, while the results reported here contradict assumptions in some quarters about the negative impact of aid on taxation, the fact that they are based on a much improved data set, and that they echo several other recent studies, suggests that these results should be taken seriously. This certainly does not mean that we should not be concerned with the potential for foreign aid to reduce incentives for domestic tax collection. Instead, it suggests the need for a more nuanced and refined understanding of the impact of aid on tax revenue collection. This issue is taken up in detail in Chapter 11.

5.1.3. Tax effort Scores

Having conducted the econometric analysis, the final step is to generate a set of tax-effort scores for each country and year. Tax effort is calculated as the ratio of actual tax collection to predicted tax collection, and is a rough indicator of the effectiveness of revenue mobilization efforts in each country. Alongside tax revenue as a share of GDP, tax effort scores are a useful basis for making comparisons across countries, and within countries over time, and thus offer a valuable input into the case selection process.

Table 4 reports tax effort scores for every country in the sample. These values rely on a very simplified model in which total tax revenue is a function of only the two primary explanatory variables: log GDP and the trade share. These two variables could reasonably be replaced with agricultural share and import share, but the results are broadly similar. Unlike the approach adopted by many earlier studies, this approach excludes the non-tax revenue and foreign aid variables in calculating the tax effort scores, reflecting a substantive judgment about what it is that these tax effort scores are meant to tell us. When the non-tax and aid variables are included, tax effort scores tell us how much tax revenue a country is collecting relative to what we would *expect*, given access to external resources and the existence of external pressures. By contrast, when these variables are excluded, as is the case here, the tax effort scores tell us how much tax revenue is collected relative to what reasonably *could be collected*, given underlying economic conditions. The approach adopted here is based on the belief that the latter meaning is more relevant for comparing tax performance across countries.

In calculating tax effort scores it is important to be aware of the impact of model specification on the results, and Table 5.A1, in the Appendix, reports two sets of tax effort scores, the first using a simple fixed effects model, the second using a fixed-effects model with a Baltagi-Wu correction for serial correlation. In all available cases the tax effort scores reported here are based on average values of the relevant variables during the period 2003-2005; where data is unavailable for those years data for the period 1998-2000 is used instead.¹⁸

5.2. Case Selection

The analysis so far has achieved two goals: it has highlighted the complexity of the relationship between aid and domestic taxation and it has provided additional information to support the case selection process. The remainder of the chapter is devoted to laying out the factors that shaped the selection of Ghana, Kenya and Ethiopia for in-depth case studies,

¹⁸ This applies to the Central African Republic, Djibouti, Equatorial Guinea and Mauritania, while, as noted in the previous chapter, no reliable data is available for Somalia and Togo.

while also situating those cases in the context of broader experiences in the region. Ultimately, case selection was driven by four primary considerations: Levels of tax collection and tax effort, changes in tax collection and tax effort, the importance of foreign aid and achieving variation in key political and economic variables. All else being equal preference was also given to conducting research in countries in which data was readily available and in which there was at least some existing research on taxation.

5.2.1. Levels of Tax Effort

The first case selection criterion was that case study countries have relatively high levels of tax collection and tax effort. The research methodology is premised on exploring political responses to efforts to increase taxation, and as such countries with low levels of tax collection are unlikely to offer sufficient analytical material. Quite simply, where there is little or no taxation it is unlikely to be possible to study taxpayers' responses to taxation or government strategies for securing tax compliance. As was noted in the introduction to the thesis the most notable consequence of this methodological choice is the exclusion of oil producing countries, which have universally low levels of tax effort and non-oil tax collection. By contrast, the three case study countries all have tax effort scores above one. Kenya and Ghana are among the most effective tax collectors in the region, measured by tax revenue or tax effort, while Ethiopia also achieves a relatively high level of tax effort, despite a relatively low absolute level of tax collection, which reflects the fact that it is a very poor, agrarian, economy.

5.2.2. Changes in Tax Collection and Tax Effort

Just as the research methodology calls for countries with comparatively high levels of tax effort, it calls for countries that have experienced significant changes in tax performance over time. This is, again, a pragmatic requirement, as episodes of significant change in levels of tax collection are expected to offer the greatest analytical leverage in studying political responses to taxation. While this is a seemingly straightforward requirement, in practice major changes in tax performance are relatively rare in sub-Saharan Africa, and elsewhere (Bird 2008). Kenya, Ghana and Ethiopia have nonetheless all experienced dramatic changes in tax performance over time, as reflected in Figures 5.4 through 5.6.

Ghana is alone in having experienced a relatively continuous, and dramatic, increase in tax effort over time, and thus intuitively would seem to offer a likely context for tax bargaining. By contrast, both Kenya and Ethiopia have experienced significant fluctuations in tax performance over time, offering an opportunity to explore the presence of tax bargaining during periods of increasing collection and to understand the causes and consequences of declining tax collection.¹⁹

Figure 5.4: Tax Effort in Ghana 1971-2005

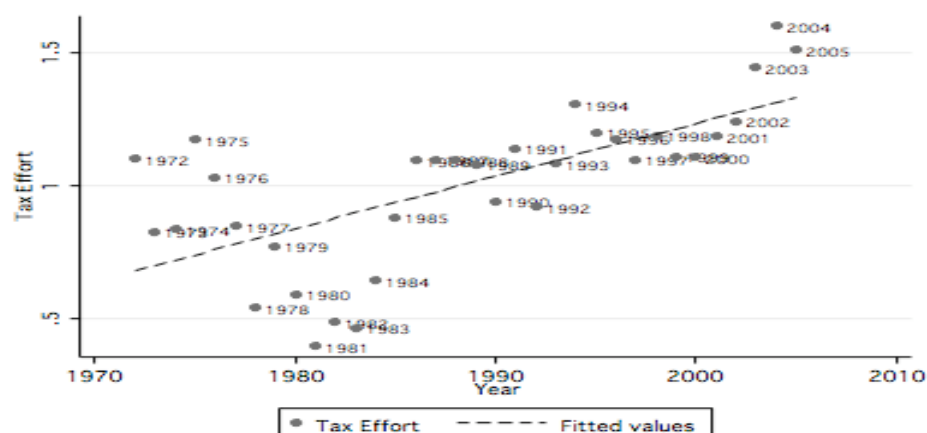
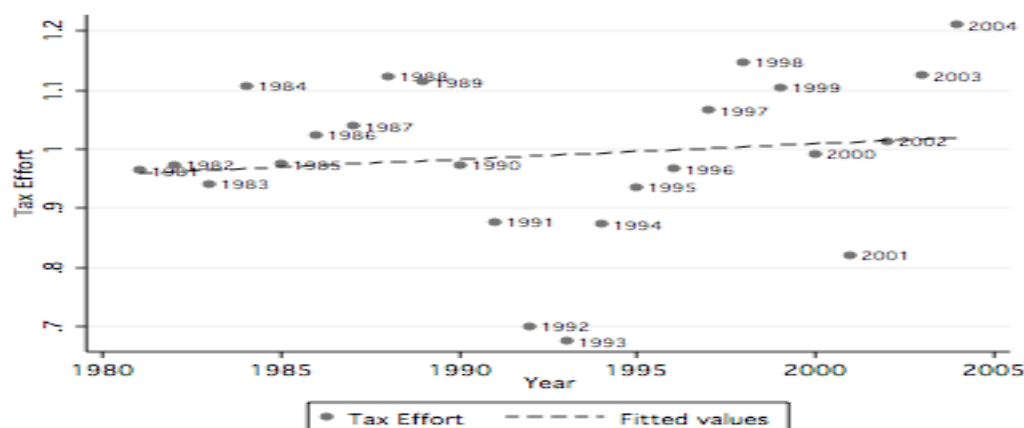
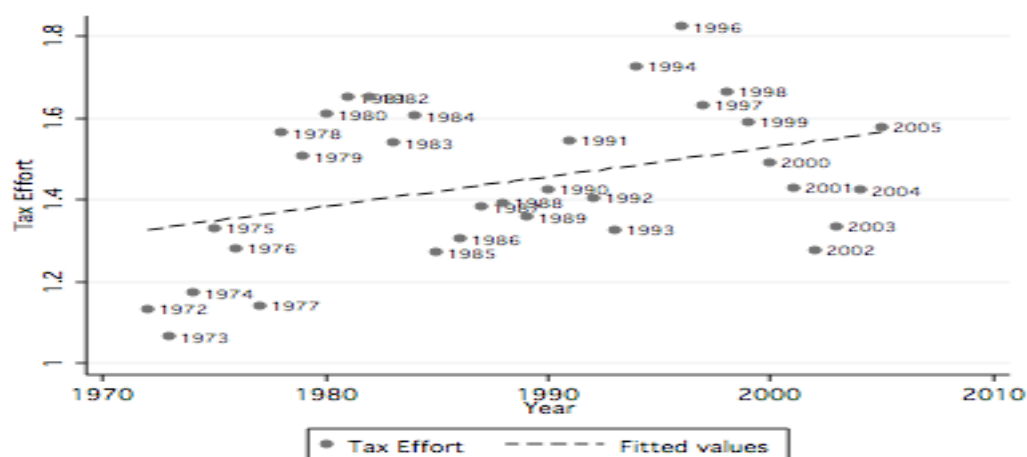


Figure 5.5: Tax Effort in Ethiopia 1981-2004



¹⁹ It is worth noting that short-term fluctuations in tax effort may in some cases reflect economic or political cycles, or idiosyncratic features of individual countries. By contrast, the changes in tax effort in both Ethiopia and Kenya have occurred in long waves, suggesting more fundamental changes.

Figure 5.6: Tax Effort in Kenya 1972-2005

5.2.3. The Impact of Foreign Aid

The third factor of interest in selecting cases has been the potential impact of foreign aid. This chapter has already noted recent scholarship arguing that aid may reduce incentives for domestic tax collection, and thus for tax bargaining, by virtue of offering governments an alternative source of non-tax revenue. At the same time, there are compelling reasons, including the ambiguous econometric results presented earlier in the chapter, to believe that the relationship between aid, domestic taxation and tax bargaining may be significantly more complex. This suggests that there is likely to be significant value in focusing on countries with different levels of aid dependence, and in which the impact of aid on levels of domestic tax collection appears to vary.

As discussed earlier, and illustrated in Figures 5.1, 5.2 and 5.3, Ghana, Kenya and Ethiopia satisfy these criteria. With respect to levels of aid dependence, both Ghana and Ethiopia have received foreign aid worth greater than 10% of GDP in most years since the beginning of the 1990s. In recent years Ethiopia has received almost 20% of GDP in aid, making it one of the most aid-dependent countries in the region outside of immediate post-conflict settings. By sharp contrast, Kenya has consistently been among the least aid-dependent countries in the region since the early 1990s, with aid levels never exceeding 10% of GDP since 1993. These three countries also offer diversity with respect to the apparent relationship between aid and taxation. In Ghana, increasing aid and tax effort have largely

gone hand in hand, offering the possibility of insights into the potentially positive impact of aid on tax collection. By contrast, the long-term relationship between aid and taxation in both Kenya and Ethiopia has shown no consistent pattern. While this may be taken as evidence of the absence of a relationship, the more likely explanation, which is borne out by the case studies, is that it reflects a changing relationship between aid and taxation over time. These countries thus offer the potential to provide particularly interesting insights into how aid affects domestic taxation.

5.2.4. Political and Economic Variables

Finally, having satisfied the preceding criteria, there is additional value in looking at cases that exhibit significant variation in their social, political and economic characteristics. This variation holds the potential to expand the validity of the results to a broader range of social, political and economic contexts, and may yield greater insights into the impact of contextual factors on tax bargaining outcomes. While it would be impossible to capture the entire range of possible variation, three factors are particularly noteworthy: the extent of political representation, the level of economic development and the socio-historical context for taxation.

With respect to the extent of representation, the three countries offer significant variety. Ghana is particularly striking as it experienced military rule throughout much of the 1970s and 1980s, including a period of particularly strong military control in the 1980s, but has since emerged as arguably the most democratic country in the region. By contrast, Ethiopia has long been among the most politically autocratic countries in sub-Saharan Africa. This was most obviously true under the socialist Derg regime from 1974-1991, but even the post-1991 government has maintained a high degree of political control. Finally, Kenya falls somewhere in the middle, as it has maintained a moderate degree of political openness virtually throughout its post-independence history, but has also only held one election, in 2002, which was entirely competitive and free of controversy.

The three case study countries are also diverse in economic terms. At one end of the spectrum lies Kenya, which has long been viewed as the region's economic success story,

and ranks highly in terms of both per capita GDP and the strength of the private sector. At the other end of the spectrum lies Ethiopia, which is among the poorest and most agrarian economies in the world, and where the private sector is particularly weak owing to an extended history of socialist rule and government control of the economy. Ghana provides a middle ground, as it suffered a dramatic economic crisis beginning in the late 1970s, but has experienced relatively consistent growth since then, making it one of the strongest economies in the region by the end of the period under study.

Finally, if we step back to look at the broader historical context, the three cases again offer significant diversity. While both Kenya and Ghana emerged from British colonial rule at the beginning of the 1960s, their experiences before and after independence have been vastly different. Kenya was a settler colony, and thus became home to a large racial minority that was able to maintain a dominant economic position even after independence. More generally, while Kenya has been among the most economically and politically stable countries in the region since independence, Ghana, like many sub-Saharan African states, prospered in the decade immediately after independence, but was plagued by repeated military coups and a dramatic economic breakdown during the 1970s and 1980s, including a near total collapse of tax revenue. As a result, while Kenya's tax system has been relatively robust and stable for almost five decades, tax collection in Ghana has been rebuilt almost from scratch since the early 1980s. The inclusion of Ethiopia introduces a much broader historical diversity, as it is the one country in the region to have largely avoided colonial rule, and also to have been home to a full blown socialist state. As will be seen in Chapter 8, these particularities offer compelling insights into the conditions that can shape the potential for, and outcomes of, tax bargaining.

5.3. Conclusions

This has been a transitional chapter, marking the shift from the historical and econometric analysis of the previous two chapters to the detailed contemporary cases studies to come. The first objective of the chapter has been to cast light on the nature of the relationship between foreign aid and domestic taxation. The key message of the analysis presented here is that the relationship between aid and taxation is likely to be complex, and warrants a

more nuanced treatment than is possible using cross-country econometric tests. While the case studies to follow do not focus explicitly on the impact of aid on domestic taxation it is a question that lurks in the background, given the obvious potential for aid to shape incentives for domestic taxation and tax bargaining. We will return to the question of aid, taxation and tax bargaining in the penultimate chapter of this thesis, by which point it will be possible to draw on the econometric evidence, a broader range of secondary literature and, most importantly, the insights provided by the case study chapters.

The second objective of this chapter has been to justify the selection of Ghana, Kenya and Ethiopia for the case studies to follow, and to situate the experience of those countries within the broader context of sub-Saharan Africa. This is an essential process, as it defines the scope of the research, and thus its likely relevance beyond the specific context of the three case study countries. The discussion here has made clear that while case selection has been shaped to a large degree by pragmatic research considerations, the three countries also achieve significant diversity with respect to changes in taxation over time, the apparent relationship between aid and taxation, key economic and political characteristics and the broader historical context. This suggests that the findings that emerge from the case studies to follow are likely to also have broader relevance.

5.4. Appendix: Table 5.A1: Tax Effort By Country 2003-2005

	Fixed-Effects			Fixed-Effects with AR(1) Correction		
	Predicted	Actual	Tax Effort	Predicted	Actual	Tax Effort
Angola	18.185	7.956	0.437	17.355	7.956	0.458
Benin	12.899	15.286	1.185	13.511	15.286	1.131
Botswana	18.989	17.282	0.910	13.659	17.282	1.265
Burkina Faso	12.055	11.146	0.924	13.267	11.146	0.840
Burundi	10.686	18.324	1.714	14.233	18.324	1.287
Cameroon	14.658	10.411	0.710	13.180	10.411	0.789
Cape Verde	17.762	19.812	1.115	15.410	19.812	1.285
Central African Republic	12.105	8.570	0.707	13.320	8.570	0.643
Chad	14.327	5.614	0.391	16.315	5.614	0.344
Comoros	13.406	9.710	0.724	13.678	9.710	0.709
Congo, Dem. Rep.	11.325	7.501	0.662	15.671	7.501	0.478
Congo, Rep.	18.615	8.022	0.430	17.510	8.022	0.458
Cote d'Ivoire	15.727	14.754	0.938	15.399	14.754	0.958
Djibouti	17.208	21.776	1.265	16.290	21.776	1.336
Equatorial Guinea	25.776	4.127	0.160	23.544	4.127	0.175
Eritrea	13.759	21.747	1.580	16.620	21.747	1.308
Ethiopia	11.402	14.579	1.278	14.505	14.579	1.005
Gabon	20.115	12.938	0.643	14.955	12.938	0.865
Gambia, The	15.226	16.530	1.085	16.538	16.530	0.999
Ghana	14.323	21.119	1.474	15.877	21.119	1.330
Guinea-Bissau	12.798	9.106	0.711	16.233	9.106	0.560
Guinea	13.768	8.356	0.606	14.132	8.356	0.591
Kenya	13.928	20.154	1.446	14.435	20.154	1.398
Lesotho	18.246	41.133	2.254	18.881	41.133	2.178
Liberia	12.560	9.650	0.768	16.008	9.650	0.602
Madagascar	13.212	10.329	0.781	15.060	10.329	0.685
Malawi	12.770	21.368	1.673	15.815	21.368	1.351
Mali	13.167	15.962	1.212	14.856	15.962	1.074
Mauritania	14.852	16.200	1.090	15.457	16.200	1.048
Mauritius	20.731	17.053	0.822	15.480	17.053	1.101
Mozambique	13.729	12.207	0.889	15.126	12.207	0.807
Namibia	18.650	27.360	1.467	15.139	27.360	1.807
Nigeria	15.187	8.562	0.563	15.815	8.562	0.541
Niger	11.477	10.123	0.882	13.999	10.123	0.723
Rwanda	12.335	12.266	0.994	13.616	12.266	0.900
Sao Tome	17.039	13.904	0.816	18.671	13.904	0.744
Senegal	14.698	18.188	1.237	14.736	18.188	1.234
Seychelles	24.620	35.368	1.436	19.096	35.368	1.852
Sierra Leone	12.863	11.395	0.885	14.873	11.395	0.766
Sudan	13.503	7.142	0.528	13.320	7.142	0.536
Swaziland	20.993	28.718	1.367	19.495	28.718	1.473
Tanzania	13.022	10.812	0.830	13.778	10.812	0.784
Uganda	12.509	12.263	0.980	13.693	12.263	0.895
Zambia	13.198	16.980	1.286	13.772	16.980	1.232

6. Taxation, Responsiveness and Accountability in Ghana 1981-2008

Before moving on, a brief summary of the thesis to this point is in order. Chapters 1 and 2 presented a detailed theoretical and conceptual framework for understanding the relationship between tax reliance and the emergence of more responsive and accountable government. Building on this foundation, Chapter 3 provided evidence that the political processes that linked taxation and state building in early modern Europe were similarly relevant in Imperial Ethiopia, thus confirming that such processes are not unique to a particular cultural or historical context. Having thus made an empirical case for exploring these processes more broadly, Chapter 4 turned to contemporary sub-Saharan African states and presented cross-country econometric evidence that while cross-country data is consistent with the predictions of the research hypothesis, it is not possible to conclusively establish a causal relationship owing to problems with data and model specification. These findings point toward the value of exploring the relationship between taxation and the expansion of responsiveness and accountability through detailed case studies, and Chapter 5 presented the rationale for pursuing contemporary case studies in three countries: Ghana, Kenya and Ethiopia.

This chapter presents the first of these three cases studies; evidence from Kenya and Ethiopia is presented in the two chapters to follow. These cases studies rest on a simple premise: If taxation is an important contributor to expanded responsiveness and accountability then it should be possible to observe processes of direct and indirect tax bargaining. While it is certainly possible that taxation may also shape political dynamics in more subtle and unobservable ways, it is difficult to claim that taxation is of central political importance if issues around taxation have not at least occasionally prompted discernable cases of tax bargaining. In order to capture specific cases of tax bargaining, each chapter presents a historical narrative of the political economy of taxation and then focuses on the analysis of particular tax episodes: moments of significant tax reform, changes in tax collection or political debates about taxation.

The Ghanaian case study is presented first because it provides the most compelling and clear-cut evidence of tax bargaining playing a prominent role in shaping the responsiveness and accountability of government. The chapter begins with an analytical historical narrative of the political economy of taxation in Ghana since 1981, the starting date a reflection of the fact that 1981 was a moment of profound economic and political transition. Although focused on taxation the narrative is shaped by the broader political and economic developments of the period. The essential question that it answers is what major changes in taxation occurred and why. The second part of the chapter assesses whether the narrative thus told amounts to persuasive evidence that taxation has been a driver of expanded responsiveness and accountability.

6.1. The Political Economy of Taxation in Ghana, 1981-2008

In 1981 the Ghanaian state and economy were deeply in crisis. The preceding five years in particular had been defined by rapid economic decline, rampant rent-seeking and the atrophying of the state. The democratically elected government of Hilla Limann had replaced a string of military governments in 1979, but had been unable to slow the downward trend. Government revenues had fallen to below 5% of GDP, which was not nearly sufficient to sustain a well functioning government, and reflected the state of economic and political collapse (Chazan 1983).

This changed dramatically when military officers led by Flight Lieutenant Jerry Rawlings took power on Dec 31, 1981 under the banner of the Provisional National Defence Council (PNDC). Rawlings had already gained a reputation for ruthlessly attacking the perceived corruption of previous regimes during a short-lived seizure of power in 1979. This ruthlessness, coupled with the simple weakness of other forces within society, allowed the new regime to establish unquestioned dominance relatively quickly, ushering in what historian Adu Boahen (1987: 135-36) has called the period of the “Culture of Silence”. While the government arrived under the banner of populist revolution, the regime ultimately used its political dominance to implement an IMF and World Bank sponsored structural adjustment program, known as the Economic Recovery Program (ERP). The vestiges of the early ideology nonetheless remained in evidence, particularly in several

early measures that took aim at the purportedly ill-gotten gains of the political and economic elite.

The second Rawlings coup represented a major break in the economic and political history of the country, and thus provides a sensible starting point for the analysis presented here (Nugent 1995, Herbst 1993, Chazan 1983). What follows divides subsequent Ghanaian history into several periods, each of which exhibits particular political dynamics surrounding taxation. The Appendix provides a detailed view of the evolution of tax collection and expenditure over the entire period.

6.1.1. 1983-1987: The Imperative of Revenue Generation

By 1983 the new regime had consolidated power and initiated the ERP. This entailed major economic reform, including efforts to rapidly increase government revenue. Academic writing on tax reform during the period tends to focus on major institutional reforms undertaken in 1985-86. These reforms fundamentally re-organized the institutional structure for tax collection, creating the National Revenue Secretariat (NRS) to oversee the Internal Revenue Service (IRS) and the Customs, Excise and Preventive Services (CEPS). Each agency was granted increased independence from the Ministry of Finance in a pioneering example of a semi-autonomous revenue authority (Terkper 1998, Osei and Quartey 2005).

While these administrative reforms set the stage for long-term improvements in taxation, the most dramatic increases in revenue occurred *prior* to these reforms, as the PNDC moved to address its crippling fiscal weakness and more than doubled tax collection between 1983 and 1985, to almost 10% of GDP. Part of the revenue improvement was attributable to the ERP, which, thanks to the rapid depreciation of the exchange rate, led to increased exports and imports, with corresponding increases in import duties, export duties, excise taxes and sales taxes. That said, all but the taxes on exports consistently, and sometimes dramatically, underperformed relative to budgeted expectations.

The impressive performance of export taxes, which were levied almost entirely on cocoa production, thus warrants special attention. From 1955-75 cocoa comprised the strong majority of Ghanaian export earnings, and an average of greater than 13% of GDP. Cocoa production was also heavily taxed through a combination of export taxes and below market prices paid by the Cocoa Marketing Board (CMB), which had monopoly control over official cocoa exports. While data is imperfect, Frimpong-Ansah (1991) estimates that from 1958-1980 cocoa taxation averaged almost 40% of the export price and accounted for 32.95% of total government revenues, and this is broadly consistent with estimates found elsewhere (Stryker et al. 1990, Bulir 1998).

These high levels of production masked the progressive decline of the sector. Producer prices during the 1960s and early 1970s were below those that prevailed prior to independence, owing to lower world prices, continued high levels of taxation and an increasingly inefficient CMB. Lower prices led to a gradual decline in production owing to lower levels of harvesting and reduced tree planting and upkeep. When world and producer prices plummeted after 1976 smuggling increased, harvesting declined and official production fell to less than 300 000 tonnes, as compared to 450 000 tonnes in the 1960s. While small farmers were relatively poorly organized politically, reduced production and increased smuggling were effective forms of everyday resistance (Scott 1985, Chazan 1983, Widner 1993, Herbst 1993).

Even as decline set in the government continued to extract a large revenue surplus, but this revenue stream dried up at the end of the decade. The growing economic crisis included the dramatic overvaluation of the exchange rate, and this depressed the real value of cocoa exports, such that neither producers nor the government was able to profit. Ultimately, mismanagement, short-sighted revenue goals, and major exchange rate imbalances eroded an essential economic sector, and dramatically undermined the fiscal solvency of the government (McMillan 2001, Frimpong-Ansah 1991, Stryker et al. 1990).

Given this history, it is little surprise that cocoa played an important part in the fiscal recovery. With the devaluation of the currency, exports resumed, and export taxes

averaged 3% of GDP, and accounted for more than 25% of total government tax revenue, during the period 1985-87. Further supporting the recovery was an increase in prices paid to producers, as the producer share of world prices was increased from 1983-85 and these higher prices for producers were sustained by the subsequent recovery of world prices. While the government continued to extract significant revenue from the cocoa sector, its early policy stance nonetheless broke the pattern of unsustainable exploitation in favor of long-term improvements in production. In doing so the PNDC resisted the urban bias of the past, adopted a longer-term view and sought to gain the support of rural constituents (McMillan 2001, Stryker 1990, Martin 1993).

Alongside export taxation, the most unexpected source of increased revenue was a dramatic increase in corporate and personal taxation. This is attributable to the Citizens Vetting Committees (CVCs), which, reflecting the ideological radicalism of the early Rawlings years, identified citizens of conspicuous wealth who were suspected of tax evasion. Where that wealth could not be accounted for and/or taxes had not been paid, the CVCs enforced tax compliance in a somewhat *ad hoc* and extra-legal manner, collecting not only annual taxes, but also substantial tax arrears, which accounted for the dramatic surge in revenue from 1983-85. While many elites resent the events of this period, and the methods employed to pursue these revenues, there is no question about the short-term effectiveness of the strategy.

Ultimately, the virtual collapse of government revenue in the early 1980s had created a desperate need to expand the fiscal capacity of the state. This was matched by the ideological commitment of the government to bringing elites back into the tax net and reviving some notion of a “social contract” (Nugent 1995). Lurking in the background were the IMF and World Bank, both of them influential advocates of tax reform and increased tax collection. The rapid pace of reform bred major discontent among elites, but witnessed very little overt public opposition, owing to the entrenched position of the government and its popularity in many circles. In the words of one senior tax official, the government “put the fear of God in them [taxpayers]. They were practically running to the tax office to pay their taxes.” Thus, the expansion of tax revenue resulted from a

combination of expediency, ideology and outside pressure, all implemented effectively by government decree.

6.1.2. 1988-1991: Rationalization and Consolidation

Total tax collection as a share of GDP stagnated at about 12% of GDP from 1988-91, but this figure masks major compositional changes. The shares of export taxes and corporate taxes plummeted, and were progressively replaced by sales taxes, import duties and fuel taxes. These changes were facilitated by major improvements in administrative capacity resulting from the administrative reforms of 1985-86.

The rapid decline in export taxation followed a sharp fall in world cocoa prices. In the face of falling world prices the government maintained real producer prices at a relatively constant level, thus sacrificing government revenue in favor of the long-term rehabilitation of the sector. This decision broke with the short-term revenue focus that had characterized earlier regimes and marked a major transfer of benefits to rural constituents (Martin 1993, Herbst 1993).

Politically, the decision to maintain cocoa prices reflected both external pressure and the political interests of the regime. Externally, the World Bank in particular favored reduced export taxation in order to spur cocoa production. Internally, President Jerry Rawlings had an ideological commitment to supporting rural areas and to maintaining producer prices. More generally, there appears to have been a desire to build a rural political constituency for the PNDC, which ran counter to the long standing urban bias of parties in Ghana and much of sub-Saharan Africa (Bates 1981, Martin 1993, Herbst 1993).

The rapid decline in corporate taxation had a more technical origin, but also reflected the ideological evolution of the regime. The dramatic increase in corporate tax collection had been reliant on both improved enforcement and the collection of substantial tax arrears. The revenue from arrears could only provide a temporary burst before being exhausted. Two other factors were also at play. First, with revenue stabilized, the government, under pressure from the IMF and World Bank, wished to reduce the tax burden in order to

promote private sector growth. Second, as the revolutionary fervor of the populace abated the government was compelled to relax the aggressiveness of the sometimes extra-legal pursuit of large taxpayers.

As export and corporate taxation declined, the government remained opportunistic in seeking ways to strengthen still relatively low tax revenues. This was most apparent in the case of government controlled petroleum prices, which experienced a very sharp rise in late 1990 in response to world price increases caused by the Gulf War. In early 1991 when world fuel prices declined the government chose to maintain increased domestic prices, thus increasing the share of taxes in the pump price of gasoline from 16.5% in early 1990 to 47.8% by mid-1991. The Gulf War had justified the original price increase, and thus obscured the subsequent imposition of additional taxation from public view. This ensured that public opposition was modest, leading one key policy maker to view the increase in petroleum taxes as “opportunistic”, “a windfall” and “a God send”.

The only troubling development of the period in the realm of taxation was the reversal of some of the earlier administrative reforms in 1991. The creation of the NRS in 1985 had given it significant independence from the Ministry of Finance, had allowed for improved conditions of work within the tax agencies and had included the creation of the post of Minister of Revenue. The revenue gains that resulted from more skilled staff and greater political focus were undeniable, but the new structure also bred jealousies. At the highest level, the Minister of Finance felt that his authority was being undermined, while within the bureaucracy complaints were emerging about special treatment being afforded to the revenue agencies. Thus, the Minister of Finance moved to abolish the NRS and bring the tax agencies back under Ministerial control in 1991. This move immediately prompted a modest decline in revenue collection, as overall political attention to tax collection wavered, as did bureaucratic morale. This episode demonstrated both the difficulties inherent in major administrative reform and the threat to the effectiveness of tax collection posed by growing political tensions at the highest level.

6.1.3. 1992-1996: Elections, Public Spending and Popular Opposition

Although overt political conflict was very rare under the military regime, that changed when an increasingly assertive domestic opposition and growing international pressure persuaded the PNDC government to hold elections late in 1992. The political temperature subsequently rose even further when Jerry Rawlings was declared victorious in the Presidential elections as head of the newly named National Democratic Congress (NDC) and the opposition National Patriotic Party (NPP) responded with accusation of electoral fraud and a boycott of parliament. While many observers believe that NPP claims of fraud may have been overblown, the boycott nonetheless created an extended political standoff (Nugent 1999, Osei 2000).

Tax issues played an important role throughout this period, beginning with the decision by labour unions, recognizing the political leverage offered by upcoming elections, to stage repeated strikes demanding increased wages and improved benefits. Given the political threat, the government capitulated to many of the demands, setting the stage for a major budget shortfall in the subsequent fiscal year. This looming fiscal crisis was exacerbated when the IMF and WB interpreted the concessions as discretionary, and reckless, pre-election spending, and cancelled aid disbursements in protest. As soon as the elections were over the government was thus confronted with the urgent need to raise revenue.

The first tax conflict occurred in 1993 when the government sought to further increase petroleum prices. Petroleum price increases were by far the most administratively simple way to quickly increase revenue, but were also highly politically salient. A first increase took effect in January 1993, days before the inauguration of the new parliament and constitution. While the increase met some public outcry, the decision to introduce the price increases before inaugurating the new parliament ensured that opposition remained fragmented. The government proposed a second price increase to parliament in the spring, assuming that the NDC dominated parliament would accept it without protest. In the words of one key policy maker at the time, “We were in for a shock”, as the increase was rejected

by parliament. With this the party leadership “realized that the whole relationship had changed,” as the executive would no longer be able to make policy by decree.

This conflict over petroleum taxation paled in comparison to the protests that greeted the introduction of a 17.5% Value Added Tax (VAT) to replace the existing system of sales taxes in 1995. The introduction of the new tax was undertaken on relatively short notice, owing to major fiscal concerns as well as additional pressure from the IMF. It resulted in arguably the most dramatic public protests of the era, and in the ultimate repeal of the tax despite its centrality to the government agenda (Ninsin 2007). The scale of the protests was attributable in part to the fact that the tax was introduced relatively suddenly, at a high rate and with limited public consultation, but also reflected the strength of broader public grievances (Osei 2000).

Much of the leadership of the protests came from the opposition NPP, but the scale of the protests was largely unexpected, as was the need for the government to repeal the new tax in order to restore order. It was, in the words of one leading participant, “a sobering moment for the government.” As important as the repeal of the tax itself, the protests came to encompass broader demands for democratization, reduced corruption and improved public services, and prompted the government to adopt a fundamentally more open governing style thereafter. The protests also figured prominently in the resignation of long-serving Minister of Finance Kwesi Botchwey, thus highlighting the depth of the political conflict (Osei 2000, Terkper 1998, Assibey-Mensah 1999).

6.1.4. 1997-2000: Open Elections, Increased Harmony and Modest Revenue Growth

The NDC won a second popular mandate at the end of 1996 in an election that was accepted by the opposition and prompted their entry into parliament. This ushered in a period of greater political harmony, as structured parliamentary debate facilitated bargaining and the NDC adopted a relatively more inclusive governing style. Nonetheless, while the NDC government continued to achieve some revenue gains, increasing public unhappiness prevented it from expanding revenue sufficiently to fully close the fiscal gap.

The VAT was re-introduced in parliament in 1998 and was smoothly implemented in early 1999. The re-introduction of the tax resulted from internal commitment and growing pressure from the IMF, while its smooth implementation reflected both policy changes and changes in the political context. First, although the government had agreed with the IMF to subsequently raise the rate to 15%, the initial rate was only 10%, which was below the 15% of the existing sales tax. Second, a major program of public outreach and education was carried out. Finally, the entry of opposition political parties into parliament increased the scope for structured debate and created a shared interest in fiscal stability, both of which reduced the likelihood that the formal opposition would again join in organizing street demonstrations (Osei 2000).

In accordance with its earlier plan, the NDC government proposed a 2.5% increase in the VAT the following year. This prompted a public outcry and the government responded by announcing that the new funds would be earmarked for a Ghana Education Trust (GET) Fund. The fund was to be used primarily for educational infrastructure and scholarships, with a focus on tertiary education. While the Ghana National Union of Students had long been mobilizing in favour of increased tertiary funding, there is ample evidence that the decision to create the GET Fund was first and foremost a politically motivated means to secure passage of the increase in the VAT rate (Prichard 2009).

Despite significant revenue gains associated with the VAT, the overall fiscal position of the NDC government remained weak. Faced with a persistent fiscal deficit, and constrained by huge debt repayment costs, the government found itself unable to further increase tax revenue. Senior officials report that while there was a desire to increase taxation they could not mobilize the necessary political support to do so in the face of growing public opposition. This was most apparent in the slow erosion of petroleum taxation to the point that the government was subsidizing fuel prices by the end of the decade. As the world price of fuel rose in the late 1990s, the government judged that due to persistent political opposition it could not afford to increase domestic prices. This political stalemate left the government fiscally crippled as it moved towards the 2000 elections.

Although it attracted less public attention, the faltering political position of the government appears to have similarly forestalled reforms in tax administration. During the 1990s several administrative reform programs remained on hold despite protests from the IFIs. These included: the functional integration of the IRS and CEPS (and eventually VAT Service as well), the creation of a Large Taxpayers Unit (LTU) and the computerization of the IRS. The government repeatedly expressed a commitment to move ahead with these initiatives in order to improve its fiscal position, but major progress did not occur until after the NPP had come to power.

The lack of progress appears to have had multiple causes, beginning with resistance within the Ministry of Finance to the prospect of a more autonomous revenue agency. There equally appears to have been some tension between the different tax agencies, as their functional integration would have reduced the control and autonomy exercised by senior officials in any individual agency. Similarly, there was bureaucratic resistance to the creation of an LTU owing to the revenue losses that would be suffered by individual offices. Many tax administrators further resisted, and even undermined, computerization efforts out of a concern that their limited computer skills would put their jobs in jeopardy (Bird and Zolt 2007). Finally, any effort at tax reform, particularly as it related to income taxation, was bound to encounter staunch opposition from the economic elite, who were among the greatest beneficiaries of weak tax enforcement (Ascher 1989). The computerization of the IRS, in particular, threatened to dramatically improve transparency surrounding the economic activities of taxpayers, with risks to those who preferred to have their activities remain secret (Fjeldstad 2005: 11-12).

While the challenges inherent in administrative reform warrant much further discussion, these issues are not the focus here. The relevant point for this research is that administrative reform in the tax agencies held the potential to generate important revenue gains, but also faced entrenched opposition on many fronts. Consequently, any reform effort would require significant political capital, and in the late 1990s the increasingly unpopular NDC government was unable to generate the necessary support.

6.1.5. 2001-2008: A New Government and Expanded Public Revenue

At the end of the year 2000 the NPP was voted into office and it immediately enjoyed significant goodwill, even among its opponents, owing to its promise of increased political openness (Frempong 2007, Amponsah 2007). This goodwill provided the government with much greater freedom than its predecessor in implementing its policy agenda. Central to this agenda was a program to restore fiscal balance in the wake of the large deficits of previous years. Two immediate measures were particularly noteworthy: Accession to the Highly Indebted Poor Countries (HIPC) initiative for debt relief, which was accompanied by a large increase in petroleum prices and petroleum taxes, and the introduction of the National Reconstruction Levy (NRL).

Ghana had first been offered access to the HIPC initiative for debt relief in 1999, but the NDC government did not accede to the agreement. This partly reflected an unwillingness to accept the stigma that President Rawlings associated with admitting the need for debt relief. More important, though, was the fact that increasing petroleum prices was a central condition of HIPC, and the government considered this to be politically impossible prior to the election. By contrast, the new NPP government quickly joined HIPC and implemented large petroleum price increases in 2001 and 2003. In fact, not only did the government increase petroleum prices, which implied proportional increases in tax revenue, but also simultaneously increased the share of taxation in the total price. Unlike the harsh reception that would have met such action by the NDC, the government faced limited popular opposition. This reflected a combination of the goodwill enjoyed by the new government, and the ability to blame the stigma of HIPC, and the hardship of new prices, on the NDC. The decision to simultaneously increase petroleum taxation demonstrated the potential for disguising new taxes within apparently inevitable price increases mandated by the IMF.

In 2004 the HIPC conditions called for the government to increase prices again, but a temporary waiver was granted by the IMF in recognition of the political difficulty posed by price increases in the run up to the election. The government thus went ahead with the promised increase in petroleum prices in 2005, after winning the 2004 elections, but having

used up some of the goodwill that greeted it in 2001 was forced to achieve the increase in part by reducing petroleum taxation. These compromises further highlight both the political salience of petroleum prices and the close relationship between the ability to raise revenue and the broader political popularity of government.

In addition to these measures related to HIPC, the government introduced the NRL in 2001 as a 2.5% surcharge tax on corporate profits, with a special rate of 15% for financial institutions. The tax was initially meant to last for three years, though it was ultimately renewed in 2004 before being removed in 2007. Surprisingly, the tax was subject to relatively muted opposition from the business community. This reflected the strategic mobilization of public opinion in favour of the tax, but also the increasingly conciliatory relationship between government and business. While the NDC had improved the business climate during its tenure, business confidence increased dramatically after the election of the NPP, while the new government also expanded consultation (Amponsah 2007). The NPP also managed to play shrewd politics when it extended the NRL in 2004, co-opting significant opposition by promising that 25% of the levy would be used to create a venture capital fund.

Having stabilized the fiscal situation the government undertook two major additional revenue measures. The first was the introduction of the National Health Insurance Levy (NHIL), which amounted to a 2.5% increase in the VAT rate, and was earmarked to fund a new National Health Insurance Scheme (NHIS). The new government was adamant that the new tax be separately quoted as the NHIL, and not be called VAT, owing to very vocal opposition to the VAT from 1994-2000. It is also widely believed that, as in the case of the GET Fund, the primary government objective was to increase revenue, while the decision to earmark funds for the NHIS was a concession to political necessity.

The second important revenue measure was the introduction of a Communications Tax, which was primarily a tax on mobile phone calls. The tax was first proposed in 2007 and was met by a significant public backlash, which prompted the government to seek a political strategy to ease its passage. The government initially claimed that the tax was

meant to offset customs losses from mobile phone smuggling, but this rationale was quickly abandoned when the public realized that the expected revenue far exceeded any plausible losses from smuggling. The government subsequently announced that the tax revenue would be earmarked to fund the Youth Employment Scheme. This proved to be an effective political strategy, but was also deeply disingenuous, as the Act itself only earmarked 20% of the revenue for youth employment, and in very vague terms at that. This highlights the scope for deception in building public support for earmarking, along with the weakness of parliament, which failed to draw attention to the discrepancy. While this parliamentary failure may reflect the simple weakness of the opposition it also suggests that with an election on the horizon the NDC may have seen the merits of increased government revenue.

6.2. Evidence of Tax Bargaining

Having presented this detailed historical narrative the challenge is twofold: First, to decide whether it constitutes evidence of a causal relationship between taxation and the expansion of responsiveness and accountability and, second, to provide an analytically rigorous account of the causal processes driving that relationship. In some cases this only requires explicitly summarizing connections that are relatively self-evident in the preceding historical narrative. In other cases additional information about the motives, perceptions and activities of political actors allows us to add nuance to the overview provided so far. On the whole the Ghanaian case presents extensive evidence of tax bargaining, and what follows captures the diversity of particular outcomes under four distinct categories, which mirror those introduced in chapter 2: taxation without bargaining, direct tax bargaining, taxation as a catalyst for public engagement and tax resistance as a contributor to changes in government.

6.2.1. Repression, Coercion and the Absence of Tax Bargaining

The first lesson that can be drawn from the Ghanaian narrative is that sufficiently coercive governments can, for a time at least, push through major new taxation without prompting effective citizen demands for responsiveness or accountability. Research on structural adjustment in Ghana has focused on the extent to which the government was sufficiently

well entrenched to be able to undertake reforms with minimal political opposition (Herbst 1993, Martin 1993). Taxation was no different. During the 1980s the government undertook major reforms of tax policy and administration, and dramatically increased tax collection, but leading government officials make clear in interviews that they had little concern for any potential political consequences.

While the overall picture during the period was thus one of coercion, rather than tax bargaining, several caveats are warranted. First, this state of affairs was temporary. By the end of the decade scattered tax protests had begun to emerge, while, as tellingly, revenue generation had reached a temporary plateau. Second, a large share of Ghanaians held a positive view of the reforms, despite the overall increase in collection. Increases in income taxation clearly targeted an unpopular and elite minority, while renewed cocoa tax collection was a reflection of improved prices and production following the devaluation of the currency. Finally, there is a sense among some observers that aggressive taxation may have quietly fueled levels of political engagement and mobilization, either at the grassroots level or within the ranks of the organized political opposition. At a minimum the aggressive taxation of elite incomes became the subject of future political attacks by the opposition, suggesting that while taxation during the period was achieved coercively it was not entirely without longer-term political consequences.

6.2.2. Direct Tax Bargaining: Protests, Earmarking and Compromise

While the expansion of taxation in the 1980s was driven by coercion, there is significant evidence that tax bargaining was an important contributor to the process of democratization in the first half of the 1990s, and to the further expansion of responsiveness and accountability thereafter. While these political processes undoubtedly had multiple and complex roots, the goal here is to highlight the important contribution of relatively direct forms of tax bargaining. The analysis focuses on three distinct parts of this story: tax protests and democratization in the early 1990s, tax earmarking and government responsiveness during the next decade and the particular case of tax bargaining around informal sector taxation.

6.2.2.1. Tax Protests and Government Accountability

As Ghana slowly emerged from a period in which political opposition was sharply controlled, various anti-tax mobilizations, particularly by traders, were among the first signs of political agitation. A senior PNDC official explained that, “the first time I felt political pressure was from the women who were going to Nigeria and bringing back plastic goods.” When the government tried to crack down through the collection of customs taxes the traders organized to resist. Likewise, the Ghana Union of Traders Association (GUTA) was formed as part of mass protests responding to new municipal market taxes introduced in 1989. While these early examples were ultimately repressed, they are evidence of the role played by tax protests in opening space for political opposition.

More significant was the political conflict that surrounded efforts to increase petroleum prices in 1993. While the PNDC government had been able to implement price increases by decree earlier in the year, the second fuel price increase in 1993 was rejected by the NDC controlled parliament. In acting against its own executive the NDC parliament was responding to public outcry against the first fuel price increase, which had led the budget to be dubbed the “killer budget.” While the government did not make immediate concessions during the parliamentary debate over the proposed price increases, party officials make clear that the emergence of public and parliamentary opposition forced the leadership to rethink their highly centralized approach to decision-making. The debate thus changed the informal rules of decision-making and accountability.

A very similar, but more dramatic, process played out two years later with the repeal of the newly introduced VAT amid mass public demonstrations that left several people dead. The protests, known as *Kume Preko*, were loosely organized by the Alliance for Change, which comprised civil society leaders as well as prominent members of the opposition NPP and other political parties. The involvement of the formal political opposition was pivotal and resulted from the fact that they had boycotted parliament and thus were compelled to engage in mass politics rather than parliamentary debate. While the protests were initially a response to the VAT, they quickly came to encompass a much broader range of grievances against the government, including demands for political liberalization. The eventual

government decision to repeal the VAT was of major consequence, as it was both profoundly embarrassing and significantly undermined its fiscal and economic objectives.

In the long term what was most noteworthy about the protests was that they significantly advanced the process of democratization in the country. For the opposition, the protests were a watershed, as, unlike during the elections, they were able to present a fully unified front. This greater unity carried over to subsequent elections and was a *sine qua non* of political success (Frempong 2007). More importantly, the protests made clear that the government could not continue to govern without opening the political process and inviting deliberation. Among other factors, the prominent role of opposition political parties in organizing the protests made clear to the government that it was better off with these groups in parliament than in the streets. If the government wished to pursue its policy agenda successfully it became clear that parliament would be an important institution for facilitating bargaining and dialogue (Osei 2000).

Thus, there is little doubt that conflict over taxation was a catalyst for significant changes in the informal institutions of accountability, as the role of parliament and the inclusiveness of the ruling NDC expanded meaningfully in the aftermath of the protests. A more nuanced lesson is that while taxation was a catalyst for the protests, the protests were not simply about the tax. Instead, taxation was a spark that unleashed much broader grievances. Finally, although the VAT was a broad based tax, and the protests attracted a diversity of taxpayers, elite involvement was absolutely central to what transpired. Whether or not the protests would have enjoyed the same success in the absence of leading politicians is very much open to question (Ninsin 2007).

6.2.2.2. Tax Earmarking and Responsiveness

The failed implementation of the VAT resulted in a significant expansion of accountability, but this outcome was largely implicit and was achieved through very public political conflict. By contrast, subsequent government efforts to expand taxation were characterized by relatively explicit, pre-emptive, forms of tax bargaining that ensured the smooth implementation of reform. Unlike the broad changes in accountability that resulted from the original VAT protests, these later tax bargains, which relied on earmarking tax revenues

for popular programs, were focused on more narrow improvements in the responsiveness of government.

The most dramatic examples of such tax bargaining were the earmarking of successive increases in the VAT rate to the GET Fund in 2000 and the NHIS in 2003. In both cases the preponderance of evidence indicates that the ultimate decision to earmark funds was a purely political strategy to reduce public opposition to tax increases. This is not to imply that the earmarked activities were not legitimate, and justified, government priorities. It is simply that the decision to explicitly earmark the funds, and create dedicated oversight bodies, would not have occurred if not for public resistance to the prospect of additional taxation. This marks the process of earmarking as a clear example of tax bargaining leading to the expansion of government responsiveness.

While the evidence of tax bargaining is clear, the more challenging, and more important, question is whether that bargaining resulted in genuinely improved outcomes. Put another way, the fact that the government created the appearance of responding to popular demands is not sufficient evidence that this commitment was carried out in practice. Untangling the actual impact of earmarking requires consideration of four related issues: the actual content of the legal commitment, the impact on the budget process, the risk of fungibility and the quality of oversight.

The first risk is that the government may announce that funds are being earmarked for a particular purpose but fail to follow through on that promise in practice. This was the case for the Communications Tax, as the public was led to believe that revenues would be earmarked for the Youth Employment Scheme, but in practice only a small share of revenue was allocated to that program. Worse still, even the 20% allocated to youth employment was defined so vaguely in the law as to call into question the reliability of the earmarking. Yet, despite the overt deception practiced by the government the public remained overwhelmingly unaware of the discrepancy. In this case tax bargaining was, to a significant degree, a mere “gimmick” for easing the passage of legislation.

The second concern is that the practice of earmarking can be a mixed blessing, as it is politically useful and can ensure certain types of spending, but also reduces budgetary flexibility and, potentially, the overall quality of the budgeting processes (McCleary 1991). The earmarking of tax revenue has been widely supported in the case of Road Funds, due to the chronic failure of governments to invest in road maintenance, but ‘best practice’ has generally been to discourage earmarking in other areas because of the impact on budget flexibility (Gwilliam and Shalizi 1999). While resolving this debate is beyond the scope of this research, it is possible that responsiveness through earmarking has hidden costs.

The third risk is that earmarked funds may be fungible. In such cases total funding for earmarked activities might increase by far less than the amount of the earmark as existing funds are shifted elsewhere in the budget. While this is a risk in principle, it has so far not been borne out in practice in Ghana. Overall levels of health and education funding have expanded significantly more than the amount of the new revenues earmarked for the GET fund and NHIL respectively. Two concerns persist nonetheless. First, some officials believe that the share of spending on health, outside of the NHIS, may begin to decline in upcoming years, which would be consistent with the use of earmarked funds to substitute for general budgetary funding. Second, there is evidence that the earmarked funds have not been used exclusively for their prescribed purposes within the health and education budgets. Most notably, both programs, and particularly the GET Fund, should have led to increased non-wage expenditures. Yet, in practice, the share of non-wage spending in the core health and education budgets has fallen in recent years (Lawson et al. 2007). Regardless of the justification for this choice, it indicates some degree of fungibility in the use of funds.

Finally, all of these issues point to the broader reality that the long-term impact of earmarking will be largely dependent on the extent to which earmarking strengthens the quality of internal and external oversight. In the absence of effective monitoring, deception by the government, fungibility, corruption and waste are all made more likely. The impact of earmarking in Ghana on the quality of oversight remains somewhat ambiguous and under researched. Both the GET Fund and NHIS are managed by appointed Boards of

Directors, and audited by the Auditor General, rather than being subject to the standard oversight mechanisms of the Ministry of Finance. The merit of this decision is a much larger research question, but it is not a given that the new structures will be more effective, particularly given the costs of more fragmented monitoring of the budget as a whole (Gwilliam and Shilizi 1999). Perhaps more tellingly, little attention seems to have been paid to this question by either internal or external actors despite rapid escalation in the share of tax revenue subject to earmarking.

A more interesting possibility is that earmarking may improve external oversight by making spending more transparent or by generating greater public attention and interest. While these factors are difficult to evaluate, civil society leaders generally feel that modest oversight benefits exist, but remain limited due to the lack of available information. For example, a public backlash forced the government to return revenues to the GET Fund after the government had initially appropriated tax revenues that were collected after the passage of the law but before the Fund was operational. On the other hand, the GET Fund has been beset by accusations that funds are being used beyond the originally prescribed purposes, and that it has suffered from significant corruption. There is much more to be learned about this issue.

6.2.2.3. Accountability and Cooptation in Informal Sector

Taxation

Recent government efforts to expand taxation of the informal sector have also prompted relatively explicit tax bargaining, though with mixed results. The government push to improve taxation of the informal sector has been motivated by a combination of internal commitment from tax administrators, international pressure and pressure from the major business associations. The role of business is particularly interesting, as it reflects an apparent tax bargain in its own right: formal sector businesses report that they have been willing to expand their own tax compliance on the condition that the government simultaneously endeavour to expand the tax base.

While the government has undertaken many measures to expand taxation of small and medium enterprises (SMEs) in the informal sector, this analysis focuses on two measures in

particular: taxes on public transport operators and the introduction of a Flat Rate VAT Scheme for small retailers. In the early 1990s government efforts to expand informal sector taxation initially focused on public transport using what has been called “associational taxation” (Joshi and Ayee 2008). The government agreed with the Ghana Public Road Transport Union (GPRTU) leadership that the union would collect taxes itself and then remit the revenue to government. The goal was to make compliance as simple as possible, with taxes collected on a daily or weekly basis to accommodate the difficulties that operators faced in paying large lump sum taxes. In exchange for tax compliance, the GPRTU membership expected to be relatively protected from the arbitrary assessment of penalties by the police and tax officials. While this tax arrangement was one of the first of its kind, over time the model was extended to many other sectors. This agreement was facilitated by the fact that the leadership of the GPRTU and the NDC government were close allies (Joshi and Ayee 2008).

In the short term the arrangement was a mutually beneficial tax bargain, but the relationship soured over time. The government became frustrated with the union leadership as revenues failed to expand at the expected rate and checks and balances were progressively eroded. Meanwhile, the union membership became increasingly disenchanted due to a feeling that the union leadership was pocketing much of the tax revenue that was being collected. In 2003 the agreement with the GPRTU was replaced by a Vehicle Income Tax, which mandated that every commercial operator would prominently display a tax sticker purchased from the IRS on a quarterly basis. The new scheme immediately yielded significantly more revenue, while also being more popular with much of the membership of the GPRTU.

Thus, the system of associational taxation provides a mixed picture as a form of tax bargain. On the one hand, public transport operators were successfully brought into the tax net, and, in exchange, appear to have been spared certain forms of police harassment. While these gains are relatively narrow, they are nonetheless indicative of a more responsive government. On the other hand, while the original scheme was apparently well intentioned, it evolved into a more cynically corporatist relationship. Even as collection

efficiency declined, the NDC gained the support of the union leadership by allowing them to retain part of the collection, while the union leadership remained in the good graces of government by offering legitimacy to the tax. Meanwhile, it was individual operators who were forced to pay higher taxes for smaller benefits. It was only after the exit of the NDC that the tax system was regularized.

The second prominent effort to tax SMEs has been the introduction of the Flat Rate VAT Scheme by the NPP government, and it has resulted in a similarly complex relationship between the government and GUTA. The new tax aimed to improve compliance among small retailers by replacing the more complex accounting requirements of the standard VAT with a flat 3% tax on turnover. The government would benefit from additional revenue, while traders would face reduced harassment, simpler accounting requirements and greater legitimacy. In order to ease acceptance of the new tax the government sought an endorsement from GUTA, and this did, indeed, facilitate implementation.

To some extent, GUTA entered into partnership with the VAT Service in order to create a legitimate tax bargain, with benefits for both the government and taxpayers. Yet there are suggestions in many quarters that the GUTA leadership was also willing to endorse a higher tax burden on its members in order to secure narrow personal benefits. For one, the GUTA leadership were larger traders, and thus had an interest in bringing smaller traders into the tax net in order to improve their own competitive position in a dynamic common to many countries (Goldsmith 2002). Equally, it is widely believed that the GUTA leadership were willing to cooperate with the government to further their own political ambitions or, even more cynically, to improve their access to government contracts. While these claims cannot be verified, there is a strong sense that co-optation was as much a part of the introduction of the Flat Rate Scheme as was improved government responsiveness.

6.2.3. Taxes, Civil Society and Public Engagement

The analysis so far has considered relatively clear-cut examples of direct tax bargaining, or its conspicuous absence. Yet, taxation may also encourage the expansion of responsiveness and accountability indirectly by catalyzing longer-term processes of political organizing

within society, thus expanding the ability of taxpayers to exercise oversight and make demands on government. While these processes are similar to processes of direct tax bargaining, they are distinct in that they do not involve immediately observable quid pro quo but are instead likely to encourage increased public engagement, and reform, over time. There is significant evidence that taxation has, indeed, encouraged the strengthening of civil society in Ghana, and the analysis is usefully divided into two components: broad-based advocacy groups and business associations.

6.2.3.1. Taxation and the Committee for Joint Action

The prototypical example of taxation catalyzing new civil society organizations is the creation of the Alliance for Change in response to the introduction of the VAT in 1995. While the anti-VAT protests yielded relatively immediate gains in the accountability of the government they also contributed to longer-term processes of political organizing and engagement. At the level of the formal political opposition, the period of cooperation as part of the Alliance for Change provided the foundation for more unified efforts by the opposition in the 1996 and 2000 elections (Frempong 2007). Equally important, the experience of 1995 was a precursor to the coalescing of civil society grievances in response to new taxation in subsequent years.

At the centre of these efforts has been the Committee for Joint Action (CJA), a loose association of civil society actors often working in partnership with the minority parties in parliament. The CJA has been a prominent voice of discontent with government policy, and has been most notable for its ability to coordinate mass public mobilizations. Building on the early pro-democracy movement and the VAT protests, it has demanded policies including political liberalization, anti-corruption efforts, expanded public spending and reduced taxes.

The political prominence of the CJA has ebbed and flowed over time, with its moments of strength consistently a response to high taxes. Of particular salience have been highly visible and contentious conflicts over petroleum prices (and the petroleum taxes embodied in those prices), consistent with the politicization of petroleum prices in other countries as well (Esfahani 2001, Gupta and Mahler 1995). Petroleum price increases in 1998 vaulted

the CJA to prominence as an heir to the fragmented Alliance for Change, and made the CJA a major factor in the inability of the government to implement subsequent price increases. The CJA faded from prominence amidst the goodwill welcoming the new NPP government to power in 2001, but a second round of petroleum price increases in 2002-03 catalyzed renewed activism. This pattern was repeated at the end of 2007, as the CJA led mass demonstration in the north that were reputed to be the largest since the VAT protests of 1995. The backdrop was, again, high petroleum prices, though the demands of protesters were much broader. In the words of a CJA leader, “Taxes have always provided a focal point for public mobilization. Have provided momentum for the resistance.”

6.2.3.2. Taxation and Business Associations

Taxation has likewise played an important role in the expansion of the political activism of business associations. The Association of Ghana Industries (AGI) had existed since independence, but only re-emerged as an important political player after 1999. While this has been facilitated by political liberalization the immediate catalyst for AGI’s revival was the need to respond to the VAT. Whereas sales tax had been collected after production, the VAT was collected on inputs at the point of import, only to be subsequently refunded after the final sale. This meant that a share of the firms’ working capital remained tied up in what were effectively advance tax payments. The AGI lobbied for tax compliant firms to be exempted from the upfront payment of taxes on inputs, on the assumption that full taxes would be paid after production and sale. This effort was ultimately successful and the increased staffing and political assertiveness of the AGI has persisted far beyond the initial advocacy campaign.

Other business associations offer similar, though more modest, lessons. For example, the major business associations in Ghana came together to form an umbrella organization, the Private Enterprise Foundation, in 1994, just as the VAT was initially emerging as a major political issue facing business. Similarly, the GUTA was initially formed as a response to new market taxes being imposed by the Accra Metropolitan Authority and coalesced around a series of major protests beginning in 1989.

The remaining question is what implications stronger business associations are likely to have for broader political developments. Business associations may have relatively narrow interests that differ from those of citizens in general. Thus, while some researchers view business associations as potentially important contributors to improved governance others see them primarily as rent seeking organizations (Olson 1965, Handley 2008, Goldsmith 2002). This is a broader question than can be addressed here, but the prevailing view in Ghana is that while business associations may seek certain special benefits, greater organization has, on the whole, contributed to the expansion of responsiveness and accountability. AGI has emerged as a prominent voice pushing for more open political processes and for greater macroeconomic stability, while GUTA has remained an important voice for retail traders.

6.2.4. Tax Resistance, Changes in Government and Reform

Finally, it is clear that in Ghana the revenue raising ability of successive governments was shaped by public perceptions of their performance, and this, in turn, had major implications for their political prospects. The Ghanaian case provides significant evidence that the ability of taxpayers to resist taxation by unpopular governments can contribute to the expansion of responsiveness and accountability by increasing the likelihood of a change in government and providing incentives for incoming governments to adopt a reformist agenda. While this is a particularly indirect form of tax bargaining, it is nonetheless potentially very significant.

Despite the relatively harmonious political environment that prevailed after the 1996 elections, the government experienced a progressively deepening fiscal crisis, and was unable to raise the revenues necessary to close the gap due to its growing unpopularity. While the government was successful in re-introducing the VAT, and in raising the rate, it was crippled by its inability to raise petroleum prices or to undertake desired administrative reforms. Former members of the government are adamant that their inability to raise additional tax revenue was the result of relentless popular opposition to such measures. In this way the wavering popularity of the NDC government exacerbated the fiscal crisis, which, in turn, further eroded the ability of the government to supply public services or

implement popular public policies. While the NDC may have lost the elections in 2000 in any event, there is little doubt that their revenue difficulties rendered this outcome significantly more likely, and thus made tax resistance an important means by which taxpayers indirectly encouraged reform.

Of course, the simple fact that taxation gave taxpayers and the opposition an additional lever through which to hasten the removal of the incumbent government does not necessarily imply that tax reliance made the expansion of responsiveness and accountability more likely. Drawing such a causal connection rests on the strength of three additional considerations: First, was there evidence that the new government was significantly more responsive and accountable than its predecessor; second, was there evidence that the greater responsiveness and accountability of the new government resulted in a greater ability to raise revenue; and third, was there evidence that the incoming government behaved more responsively and accountably at least in part owing to the need to increase tax collection. In Ghana there is strong evidence for at least the first two conditions, and some evidence for the third.

The arrival of the new NPP government unquestionably brought with it the expansion of political freedom and the strengthening of formal institutions of accountability. At a macro level, the Freedom House index of political and civil liberties registered one-point improvements (on a seven point scale) in both measures by 2004. At a micro level one of the first actions of the new government was to abolish the Criminal Libel Act, which restricted press freedom, while consultation with civil society was expanded and business confidence increased dramatically. While the NDC government had made large strides in these areas, it was clear that the transfer of power further changed the tone of politics.

Even more evident is that the political goodwill engendered by these measures eased the passage of revenue measures that would have been impossible under the NDC, most notably fuel price increases, the NRL and the NHIL. It is widely accepted that the new government enjoyed a revenue dividend as a result of the goodwill accompanying its political openness. There is also a general sentiment that the speed with which the NPP

government expanded the inclusiveness of policy consultation, particularly with the private sector, partly reflected the revenue pressures it faced. While there is not sufficient evidence to conclusively claim that this was a central government motive, the evidence suggests strongly that tax reliance was a catalyst for expanded responsiveness and accountability.

6.3. Conclusions

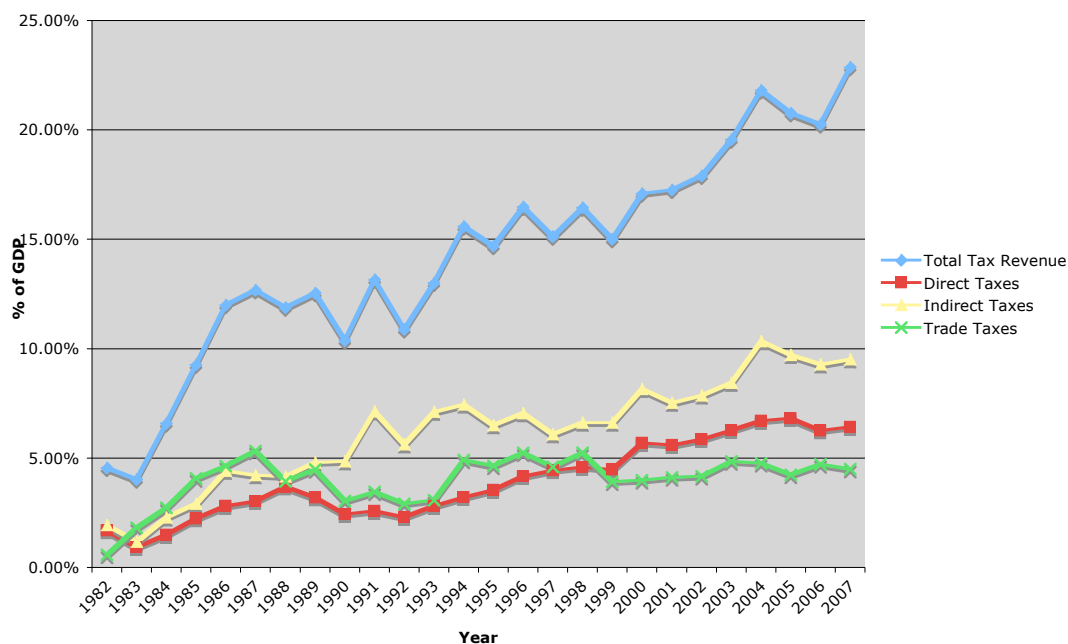
The evidence presented here leaves little doubt that in Ghana since 1981 both direct and indirect forms of tax bargaining have contributed to the expansion of responsiveness and accountability. Beginning in the late 1980s, conflict over taxation was an important catalyst for the gradual expansion of accountability, and particularly for making formal democratic institutions function more inclusively and effectively. Since the arrival of parliamentary politics in 1996 Ghana has witnessed a series of relatively explicit tax bargains in which the government has exchanged greater responsiveness for tax compliance. These have included both broad bargains surrounding increases in the VAT rate, and more narrow bargains around informal sector taxation. During this period the drive for additional taxation has likewise spurred the strengthening of civil society. Finally, government reliance on taxation gave citizens additional leverage in precipitating a change of government in 2000, with positive consequences for the subsequent expansion of responsiveness and accountability.

While highlighting the importance of tax bargaining, the case study evidence also speaks to the reality that the likelihood of tax bargaining, and the nature of particular outcomes, is likely to be shaped by context. The military government faced remarkably little opposition to major tax reforms in the 1980s, highlighting the extent to which highly repressive governments can prevent tax bargaining, at least for a time. The examples of tax earmarking and of bargaining around informal sector taxation make clear that while tax bargaining can lead to important gains, those gains will frequently rely on continued public engagement and oversight. Tax bargaining is not a one off process, and an inattentive citizenry can be misled, as appears to have been the case with the misleading earmarking of the Communications Tax in 2008.

The emerging lesson is that tax bargaining has been an important contributor to the expansion of responsiveness and accountability, but tax bargaining is a more complex process than has often been implied by earlier work. Not only is it clear that the term tax bargaining encompasses a diverse set of causal processes, both implicit and explicit, but it is also clear that particular outcomes are shaped in important ways by contextual factors. These broad messages are developed further in the two case studies to follow, while broader conclusions are reserved for chapters 9 and 10.

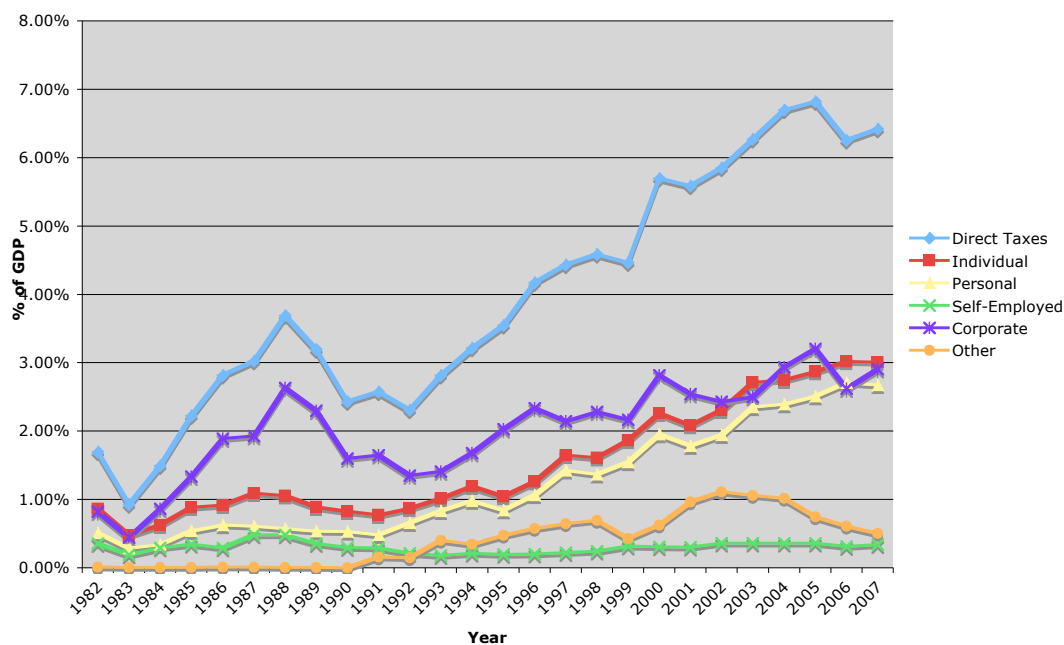
6.4. Appendix

Figure 6.A1: Total Tax Revenue by Component 1982-2007

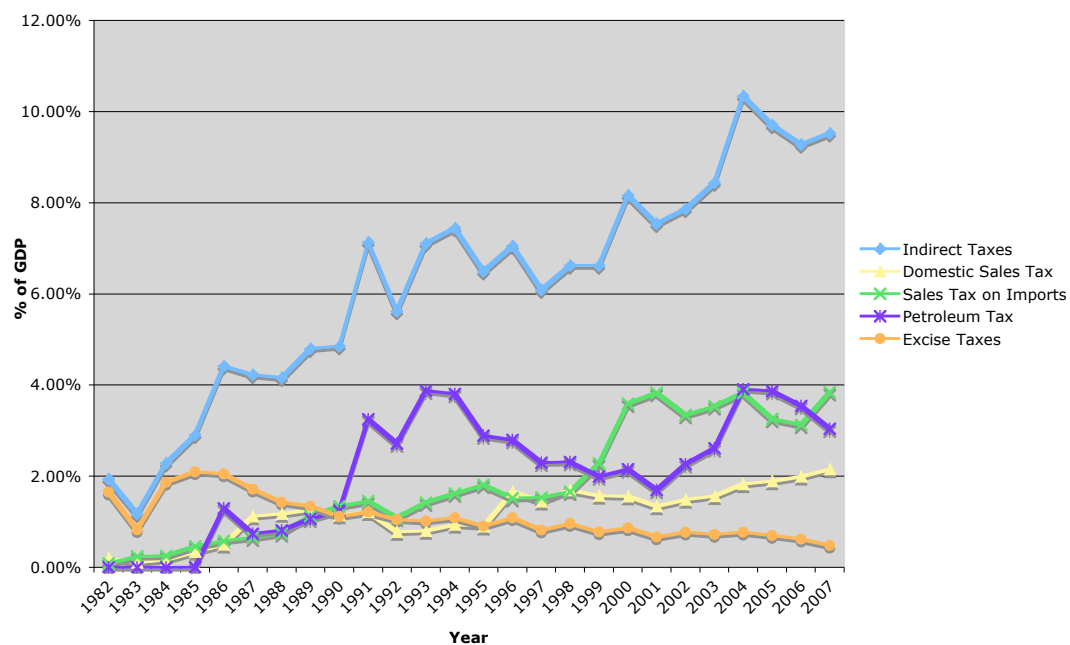


Source: Annual Budget Figures

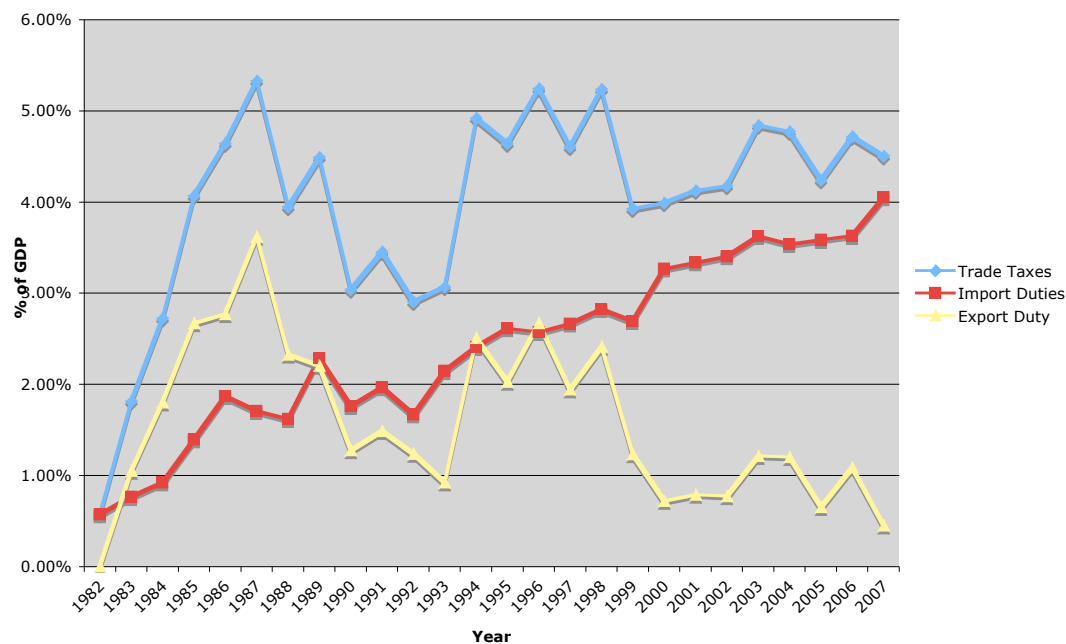
Figure 6.A2: Direct Tax Revenue by Component 1982-2007



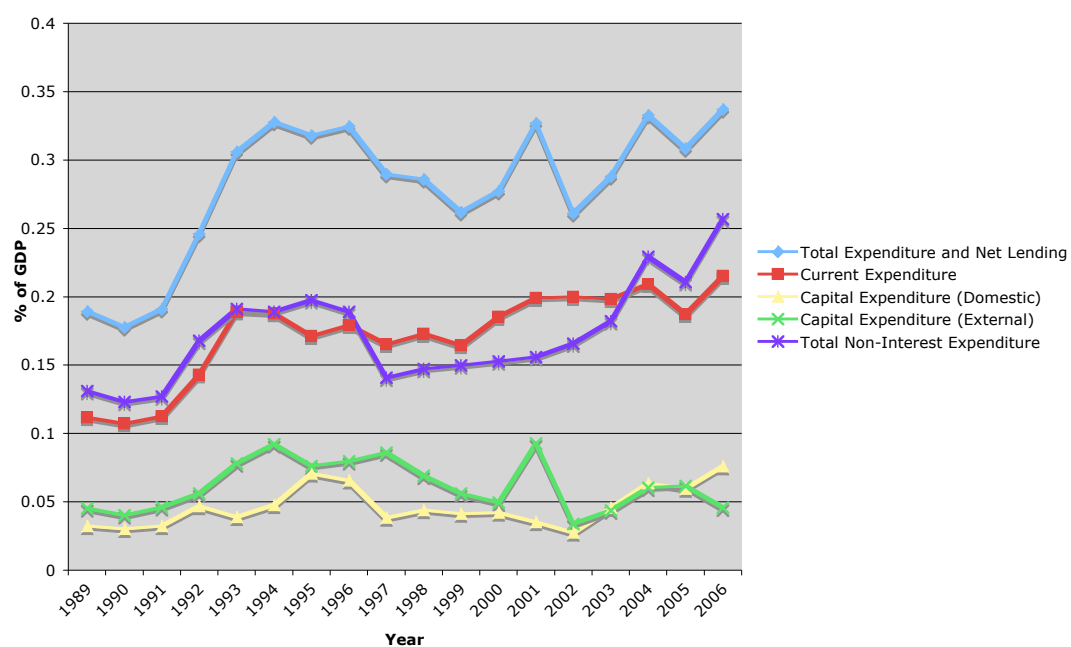
Source: Annual Budget Figures

Figure 6.A3: Indirect Tax Revenue by Component 1982-2007

Source: Annual Budget Figures

Figure 6.A4: Trade Tax Revenue by Component 1982-2007

Source: Annual Budget Figures

Figure 6.A5: Expenditure by Category 1989-2006

Source: IMF Statistical Appendixes, supplemented by annual Budget figures

7. Direct and Indirect Tax Bargaining in Kenya 1963-2008

Tax bargaining in Ghana occurred against the backdrop of dramatic changes in taxation and economic performance; in contrast, Kenya has experienced remarkable stability. Kenya has long been regarded as sub-Saharan Africa's success story, owing to a history of consistent economic growth and political stability. Despite periods of autocratic rule and economic stagnation under President Moi during the 1980s and 1990s, Kenya can still claim that, in contrast to virtually every country in the region, it has experienced neither wholesale economic collapse nor military rule. This has been reflected in tax collection, which has consistently been among the highest in the region since independence. Despite this stability Kenya has nonetheless struggled with high levels of corruption and deep ethnic and racial divisions, the latter the product of having been a British settler colony until independence.

These unique features of the Kenyan case make it a valuable context in which to study the dynamics of tax bargaining. The analysis once again begins with a detailed historical narrative of the political economy of taxation, followed by a discussion of the implications of that narrative for theories of tax bargaining. What emerges is that cases of direct tax bargaining have been comparatively rare in Kenya, but the need for taxation has nonetheless resulted in indirect forms of tax bargaining playing an important role in the expansion of responsiveness and accountability. The reasons for this particular pattern of development are analyzed toward the end of the chapter.

7.1. The Political Economy of Taxation in Kenya

Despite the economic and political stability that has prevailed throughout most of Kenya's history the country presents a complex political economy setting. Politics is often carried out behind closed doors and has been shaped by complex patronage networks, ethnic and racial divisions, powerful special interests and a sometimes very influential bureaucratic elite (Throup and Hornsby 1998). The complexity of this political environment warrants detailed consideration, but the constraints of space dictate a narrow focus here on the fiscal evolution of the state. The tax narrative that is presented here integrates broader reflections on the political economy of the country where necessary, though these are invariably

simplified caricatures of a more complex reality. What follows consequently aims not at providing a perfectly nuanced account, but, instead, at highlighting those issues that tell us most about the relationship between taxation, responsiveness and accountability. As in the previous chapter, detailed data on tax collection and expenditure over the entire period is included in the Appendix.

7.1.1. Independence and Revenue Growth 1963-73

During the colonial period, Kenya was a British settler colony and also became home to a large Asian population. The presence of the privileged white settler population contributed to the development of a more sophisticated political and economic base than in other colonies in the region, but also led to more extensive exploitation and conflict. Within the realm of taxation, the White and Asian populations were subject to income taxes, excise taxes and import duties, while the African population was primarily subjected to a poll tax, which evolved into the Graduated Personal Tax (GPT) late in the colonial period (Waris 2008). While resistance to colonial rule had broader foundations, it is worth noting that the poll tax was a source of significant political mobilization, with, for example, one of the early political associations in Western Kenya being named the North Kavirondo Taxpayers Association (Nyangira 1987).

Independence brought little change to the structure of taxation. Africans with significant incomes became subject to income taxation, while the remaining population continued to be subject to the collection of GPT by local governments until its abolition in 1974. The abolition of the GPT appears to have been largely a response to its historical association with colonial rule and exploitation, while its abolition also served to increase the dependence of local governments on the centre.

The period witnessed a progressive rise in tax revenues as a share of GDP, reflecting gradual improvement in administration and continuous economic growth in the country. By the beginning of the 1970s tax revenue had already reached almost 15% of GDP, while income taxation, at greater than 5% of GDP, had attained a level that was not meaningfully surpassed until the 1990s. In the context of significant revenue growth and broad fiscal

balance there was limited political attention to taxation, and little pressure for change (Muriithi and Moyi 2003).

The revenue gains of the period experienced virtually no public opposition, and this is attributable to three factors. First, President Kenyatta, as the champion of independence, initially enjoyed overwhelming authority and goodwill. Second, those Africans who became subject to the income tax were a very small minority, and, in the context of tremendous improvements in their overall situation, were not inclined to protest against government tax measures. Third, most of the private sector remained under the control of Europeans and Asians, so the African population, having gained political power, had strong incentives to ensure effective income taxation as a means of redistribution.

7.1.2. Uncertainty, Administrative Decay and New Taxes 1973-78

The period from 1973-1978 brought much greater uncertainty, owing to major external economic shocks and the deteriorating health of President Kenyatta (Throup and Hornsby 1998). The first major event was the OPEC oil crisis, which led to a sharp increase in world oil prices and consequently, a major foreign exchange shortage and a growing, though still manageable, fiscal deficit. In response to the growing fiscal deficit an internal constituency for expanded taxation emerged, bolstered by similar demands from the IMF, from whom the government was seeking additional foreign exchange.

In 1974 the government introduced a sales tax on most goods. The tax immediately led to large revenue gains, as goods and services taxation increased from 3.5% of GDP in 1973-74 to 5.9% in 1975-76. Despite the relatively broad incidence of the tax, it saw limited popular resistance. This is largely attributable to the factors that facilitated the expansion of income taxation: the overwhelming political authority of President Kenyatta, and the continuing assumption that the tax would be borne primarily by Europeans and Asians. A senior official put it bluntly: “Sales tax was seen to be paid by Indians and Europeans...you could find a Minister saying ‘we are not supposed to be paying that tax’”. Two other factors played a role. First, the sales tax was an indirect tax, and was often levied several levels removed from the point of sale, thus reducing the visibility of the tax to consumers.

Second, the government exempted “essential commodities” from taxation, selling the tax as a tax on luxury goods, and thus reinforcing the image that it would be borne by non-Africans (Moyi and Ronge 2006, Karingi and Wanjala 2005).

While the new tax was leading to significant revenue growth, income taxes were stagnant and trade taxes falling, as earlier improvements in administrative effectiveness slowed. Several of those interviewed attribute this weaker than expected revenue performance to Kenyatta’s flagging health and popularity. By the mid-1970s Kenyatta’s declining health weakened his attention to policy and administration and this permitted poorer performance and the expansion of official corruption (Leonard 1991: 283). Meanwhile, the assassination J.M. Kariuki in 1975, on the heels of the assassination of Tom Mboya in 1969, saw the previously unassailable popularity of Kenyatta’s government begin to decline (Throup and Hornsby 1991). This reduction in legitimacy, and in government professionalism at the highest levels, contributed to increased collusion between administration officials and taxpayers for purposes of tax evasion.

In 1977-78 there was a major surge in tax revenue, as trade taxes, sales taxes and, to a lesser extent, income taxes, increased in response to a major coffee boom that had begun in 1976. This served to disguise the declining performance of the central government and eased the foreign exchange and fiscal crises of earlier years. The death of President Kenyatta came in 1978, at the height of the coffee boom, and, after a period of intense political manoeuvring, Daniel Arap Moi assumed the Presidency.

7.1.3. Political Transition and Stabilization 1979-82

The rise of President Moi had two dramatic implications for politics in Kenya. First, unlike Kenyatta, Moi was initially relatively weak politically, and was forced to rely heavily on Mwai Kibaki, his Minister of Finance and Vice-President, and Charles Njonjo, the Attorney-General, to secure his position. Second, whereas Kenyatta had been a member of the demographically and economically dominant Kikuyu ethnic group, Moi was a member of the smaller and more economically marginalized Kalenjin group. He was consequently committed to redistributing economic resources towards the less developed areas of the

country, and particularly the Kalenjin areas of the Rift Valley. This necessitated the dismantling of Kenyatta's elaborate patronage network, and the creation of a political environment more firmly centred on himself and his allies (Throup and Hornsby 1998, Barkan and Chege 1989).

Given his relative political vulnerability, and the positive fiscal impact of the coffee boom, it is not surprising that Moi did not pursue any major taxation initiatives during his early years in office. However, despite the absence of new tax policy initiatives, tax collection was significantly stronger in the wake of the coffee boom than had been the case before it. In particular, there was a sharp and sustained increase in the collection of goods and services taxes in 1980-81. These improvements resulted from Moi's dismantling of the networks of patronage and corruption that had emerged under Kenyatta. Quoting Leonard (1991: 283): "The dangerous narrowing of the interests pursued in the late Kenyatta years was partly reversed when Daniel arap Moi became President. This correction of the ship of state was reinforced by cabinet ministers such as Njonjo, Kibaki and later, Vice-President Saitoti, who tended to think of policy in terms that were broader than immediate personal interest." While similar networks of patronage and corruption eventually grew up around Moi, the early years of transition were a period of relatively effective administration.

The only major tax event during the period was the reduction of the capital gains tax in 1981, a precursor to its suspension in 1985. The capital gains tax had initially been introduced in 1975 as Minister of Finance Mwai Kibaki responded to growing demands for equity and redistribution by seeking to tax the earnings of the wealthy. The tax was popular with the public but faced very vocal opposition from MPs and other elites who had to bear the weight of the new tax. While Kenyatta's backing had been enough to force the tax through parliament, his death opened the door for MPs to renew their demands for repeal. The reduction in the tax, and its subsequent repeal, were the predictable outcome of Kibaki's declining political influence and Moi's need to secure political allies. That said, the fact that the tax was repealed despite broad popular support, and not long after the introduction of a broad based sales tax, was an early indicator of the ability and willingness of elites to manipulate tax policy to their benefit.

7.1.4. Political and Economic Decline 1982-90

The coffee boom of the late 1970s had given rise to large increases in expenditure, and the inability of the government to rein in this spending gave rise to subsequent fiscal deficits. In response, leading technocrats in the Ministry of Finance, who were given significant independent authority, proposed a phased process of economic liberalization, along with efforts to continue to strengthen the administration of taxation in order to further increase revenue. The spirit of reform was thus in the air amidst the broadly positive developments of Moi's early years in office.

The situation changed dramatically in August 1982 as a coup attempt against President Moi put plans for reform on hold as he moved to consolidate his power (Throup and Hornsby 1998). Technocrats within the government eventually persuaded Moi to resume engagement with the IMF and the broader reform program (Leonard 1991: 215-17), but progress was slow as Moi's potential opponents were increasingly pushed out of office. While Kenyatta had monopolized decision-making power at the national level, he had generally allowed local elections and politics to be carried out unimpeded. By contrast, the elections of 1983 saw a level of electoral fraud and intimidation not previously seen in Kenya, and by 1988 elections had lost virtually all legitimacy (Throup and Hornsby 1998).

Although economic growth slowed dramatically during this period, this was largely due to political uncertainty and external developments, as economic policy retained a significant element of rationality and reform. Moi appointed George Saitoti, a talented mathematician and well respected academic, as Finance Minister in 1983, and gave Saitoti and his team of leading civil servants, led by Philip Ndegwa, Harris Mule and Simeon Nyachae, significant latitude (Leonard 1991). While corruption and other forms of public sector manipulation were becoming more widespread, it was clear to those involved that Moi saw it as being in his interest to put broad economic management in capable hands (Leonard 1991). The ambitious liberalization agenda of those reformers was summarized in Sessional Paper #1 of 1986, *Economic Policy for Renewed Growth*.

With tax revenue already high by regional standards, the President overwhelmingly concerned with consolidating power, and aid flows helping to close the fiscal gap, no significant new taxes were introduced during the 1980s (O'Brien and Ryan 2001). The tax reform agenda focused on administrative improvements, reducing income and corporate tax rates and rationalizing import, excise and sales tax rates. Despite initial enthusiasm progress was slow, as the leading bureaucrats behind the reform program had all been forced into retirement by 1987 and Saitoti's attention was diverted elsewhere when he was named Vice-President in 1988. Thus, despite the apparently genuine commitment to reform and administrative improvements, overall revenue generation declined during the decade from 18.2% of GDP in 1981-82 to 16.4% in 1990-91. While taxes on goods and services experienced a slight improvement, income tax collection fell and taxes on international trade experienced a prolonged and significant decline.

Those involved attribute the modest fall in collection to four factors. First was the growth slowdown, as both income and trade taxes tend to be higher during periods of rapid growth. Second, taxation had become more politicized, as parastatals increasingly failed to remit sales tax revenues to the tax agencies and, according to a senior tax official, "[Moi's] allies were not paying tax because they were protected." Third, the popularity and legitimacy of the regime were declining, and, as in the late Kenyatta period, this contributed to declining tax compliance and administrative probity. Finally, the overall policy-making environment remained extremely hierarchical, and this reduced the level of initiative within the tax administration.

7.1.5. Political Conflict and the VAT 1990-92

After a decade of relative inaction, the 1989 Budget Speech announced that a VAT would be implemented the following year. This announcement was remarkable both for its timing, and because of the subsequent manner in which the tax was introduced. The timing was surprising in that the announcement came just as opposition to Moi's government was becoming more politically assertive, and implementation consequently occurred during a period of high political tensions. The political repression that accompanied the 1988 elections had finally spurred the fracturing of Moi's political coalition, while the end of the

Cold War led aid donors to become increasingly assertive about the need for political liberalization. These forces culminated in a period of intense political conflict and demands for democratization, with elections eventually being held in 1992 (Throup and Hornsby 1998).

The decision to implement the VAT during this period largely reflected technocratic concerns, as the tax reform agenda had been plotted earlier, while fiscal pressure, as well as external pressure from the IMF, was mounting. However, delay was still an option. There is consequently a widespread belief that the government made a political decision that it would be best able to weather the political storm if it had greater resources at its disposal. One official explained that once it became clear that elections were going to occur the government decided that “elections were not won, they were bought.” This view is supported by the fact that increases in tax revenues in 1991-92 and 1992-93 were further accompanied by a surge in non-tax revenue.²⁰

As interesting as the motivation for the tax was the gradualist approach to implementation that was adopted. Across sub-Saharan Africa VATs have generally been implemented with a single standard rate between 10% and 20%, along with a well-defined set of exemptions, which is consistent with IMF and World Bank advice. By dramatic contrast, the Kenyan government introduced the VAT with *fifteen* rates, ranging from 0 to 150%, which broadly reflected the structure of the sales tax that preceded it (Karingi and Wanjala 2005, Muriithi and Moyi 2003).

While concerns about administrative capacity played some role in this decision, it appears to have been overwhelmingly driven by politics. By gradually moving away from the multiple rates that existed under the sales tax regime the government could simultaneously accommodate powerful, but narrow, special interests and obscure the impact of the changes from public view. Such gradualism was an established characteristic of economic reform in Kenya and officials are transparent about the fact that it was a means to reduce opposition.

²⁰ Unfortunately a detailed break down of the sources of this revenue is unavailable, while even in later years the majority of non-tax revenue is simply classified under “other non-tax revenue” in government accounts.

And, indeed, the government had achieved a more conventional rate structure by 1997, just as it had planned (Karingi and Wanjala 2005). Of course, the ability of the government to adopt this gradualist approach reflected the fact that it was not in a state of fiscal crisis and was, consequently, not entirely beholden to the IFIs and their preference for rapid reform.

Ultimately, the political strategy adopted by the government was highly successful, as revenues increased in subsequent years, while the tax prompted very little public opposition despite the tense political environment. On top of the basic effectiveness of gradualism as a reform strategy, the government won business support by simultaneously reforming the hugely inefficient system of sales tax refunds. Meanwhile the government secured public approval, as it had with the sales tax in 1974, by exempting ‘essential commodities’ from taxation and initially selling the VAT as a luxury tax. The importance of this strategy was apparent when the government attempted to apply the VAT to restaurants after the elections. They immediately encountered public condemnation on the basis that food should not be taxed, and this forced the government to rescind the VAT, which it subsequently replaced with a 5% tax on turnover. This was evidence that if the VAT had not been sold to the public effectively there likely would have been resistance. Interestingly, a 5% turnover tax on restaurants is, in fact, roughly equal in magnitude to a 15% VAT, but the government was able to take advantage of the lack of public understanding to sell the former as a tax reduction.

7.1.6. Elections, Economic Crisis and Reform 1993-97

At the end of 1992 national elections returned Moi to power thanks to the combination of a divided opposition and the shrewd use of vote buying and intimidation by the government (Throup and Hornsby 1998). The years that followed witnessed renewed economic growth, rapid economic liberalization and major improvements in tax revenue, which increased from 17.4% of GDP in 1992-93 to 20.5% in 1995-96.

The acceleration of liberalization and tax reform both flowed from a major economic crisis that emerged after the election. The government had engaged in substantial pre-election spending, and thus opened up a large fiscal deficit. The government was not able to turn to

donors, as it had in the past, because they had become more aggressive in their demands for political liberalization with the end of the Cold War, and as a result had largely cut off aid in 1991. The resulting fiscal imbalances became a full blown crisis when the government uncovered the Goldenberg Scandal²¹, which had allowed theft from the Central Bank on a sufficient scale to fundamentally destabilize the entire economy, sending inflation skyrocketing, decimating foreign reserves, and leading to massive depreciation and exceptionally high interest rates (O'Brien and Ryan 2001, Legovini 2002).

The government was consequently forced to turn to the IMF for emergency support and this accelerated the reform process at the Ministry of Finance, which was now led by an energetic and influential new Finance Minister, Musalia Mudavadi (Morton 1998). The reform program centred on devaluation and the rapid liberalization of exchange and interest rates, and included an accelerated process of tax reform (O'Brien and Ryan 2001, Legovini 2002). The rationalization of tax rates and tariffs had begun in 1986. Reform accelerated with the beginning of the donor supported Tax Modernization Program (TMP) in 1990, but the TMP only gained full political priority after the elections and in response to the fiscal crisis.

The post-1993 reforms focused on administration and prompted a dramatic improvement in income tax collection, which was further aided by a tax amnesty granted in 1994. The period witnessed, among other things, the introduction of income tax self-assessment, strengthened audit capacity, improvements in customs processes and the progressive rationalization of VAT rates. These changes were followed in 1994-95 by the creation of the Kenya Revenue Authority (KRA), which brought all of the tax agencies under one roof and provided greater decision making autonomy from the Ministry of Finance, greater flexibility with respect to hiring and salary scales and stable funding through a revenue retention scheme (Glenday 1996). While the large revenue gains of the period were partially a consequence of renewed economic growth, real improvement was evident in

²¹²¹ Orchestrated by Kenyan businessman Kamlesh Pattni in cooperation with the government, the Goldenberg Scandal saw the perpetrators receive enormous export refunds for fictitious exports of diamonds and gold.

expanded compliance by parastatals, a sustained improvement in the collection of trade taxes and improved income tax compliance.

Despite the large increase in tax collection, the reforms experienced very little popular opposition, and this is attributable to three major factors. First, the reforms were primarily administrative and did not involve introducing new taxes. As a result the changes were less immediately visible and, more importantly, they provided a weak basis for public opposition, as they were aimed at improving equity in the application of the law. Second, while elites and the business community might have been expected to vigorously oppose improved collection behind closed doors, their concerns were muted by the fact that the administrative changes continued to be accompanied by rate reductions. Further, large businesses had long sought the expansion of the tax net to medium sized firms, in order to increase competitive parity, and appear to have viewed this as an important benefit of the reform program. Finally, the elections, for all of their limitations, had provided the government with some renewed popular legitimacy. Several administrators are adamant that this improved taxpayers' compliance and that it contributed to improvements in the performance of the tax administration.

Finally, it is worth highlighting the expansion of fuel taxes, which, while small in absolute revenue terms, were indicative of the broader absence of political conflict around taxation. Beginning in 1994 the government introduced a new fuel tax, the Road Maintenance Levy (RML), increased fuel prices through deregulation and, introduced a further fuel tax earmarked for rural electrification (Wasike 2001). All of these changes had a reasonably broad-based and visible impact, but yet prompted little public response beyond the protests of public transport operators.

This can partly be explained by the effective framing of the new taxes by government: the RML reduced reliance on an unpopular and inefficient system of tolls, while road maintenance and rural electrification were both popular initiatives. The government further justified the RML by arguing that poor roads were dramatically increasing the costs of vehicle upkeep, and whether this was true or not, "the public swallowed the explanation

wholesale.” The other factor was that public transport operators, who attempted to lead resistance to the tax, were so unpopular with the public that their campaigning generated little public support. Thus, while the earmarking of the tax provided a degree of responsiveness to public preferences, the overall level of political engagement around taxation remained very low.

7.1.7. Instability and Upheaval 1998-2002

President Moi was returned to power at the end of 1997 in elections that were contested by a divided opposition and were again marred by vote buying, intimidation and sporadic violence. More troubling, however, was that 1997 marked a transition from economic growth and stability to economic stagnation and uncertainty. Economic crisis began to set in through a combination of runaway pre-election spending, a sudden and significant impasse with donors and a series of negative external shocks to the economy (Legovini 2002). Growing political conflict and instability quickly reinforced the initial economic crisis. From 1998-2002 Kenya experienced four different Ministers of Finance, beginning with Simeon Nyachae, while the civil service experienced major personnel changes, particularly in its upper ranks (Southall 1999). This political and administrative upheaval had roots in, among other things, an intensified form of winner take all politics, the fracturing of existing patronage networks, uncertainty around succession to Moi and an antagonistic relationship with donors. While a more detailed explanation of the crisis is of significant interest, it is beyond the scope of this particular account (Southall 1999).

Developments in the revenue sphere reflected the broad state of decline and uncertainty. Tax revenue experienced a dramatic fall, from 20.5% of GDP in 1995-96 to 15.7% in 2001-02. A significant part of this fall in revenue was attributable to technical factors. First, the economic crisis implied declining corporate profits, and thus lowered corporate income tax collection. Second, the reduction of tariffs under the Common Market for Eastern and Southern Africa (COMESA) treaty led to a gradual decline in import duties (Cheeseman and Griffiths 2006). This decline accelerated at the end of the decade amidst increasing problems with goods being re-imported into Kenya from other COMESA countries, and corresponding pressure for reduced tariffs for other importers. Third, and more generally,

the government was reluctant to increase tax rates during a time of severe economic recession.

Despite these technical issues, it is widely believed that declining revenue was also the result of the prevailing administrative and political turmoil, and the sheer scale of the revenue losses supports this claim. While the government remained committed to tax collection, and the administrative apparatus remained very sophisticated by regional standards, there is a belief among many senior officials that staff turnover and disillusionment with the broader political context led to declining performance. High levels of staff turnover led to a loss of competence and institutional memory, but equally had a sharply negative impact on morale. Meanwhile, the declining legitimacy and popularity of the government led to some decline in the commitment to probity within the tax administration.

The declining legitimacy and popularity of the government equally appears to have prompted declining tax compliance. In fact, several senior officials, of mixed political orientation, argue confidently that it was an informal “opposition strategy” to seek to actively undermine the fiscal position of the government. “Those who were not allies of Moi became more difficult to tax,” owing to a willingness to “do almost anything to stifle the government” and a feeling that “we don’t want to give them the money to beat us”. The impact of popular opposition to taxation carried over to the broad inability of the government to introduce new taxation. This was exemplified by a government attempt to introduce new taxes in 1998. The government proposed the introduction of taxes on low-interest loans that financial institutions were providing to their employees as a tax-free benefit. This was a relatively modest tax proposal affecting a tiny segment of the population, but became a significant factor, along with a proposal to revoke pay increases for teachers, in launching a nationwide strike. The strike came to focus on broader issues of official corruption and mismanagement and while it was ultimately broken up by force, it did lead the government to back down on the new tax proposal (Southall 1999).

The one exception to the inability of the government to secure new revenue was the introduction of a 5% excise tax on mobile phone use in 2002. The tax was attractive to the government due to its administrative simplicity and guaranteed revenue impact. It is of interest to this research because it reveals that even at times of high political tension the government was able to pass new taxation if it was sufficiently strategic, as only the service providers themselves presented significant opposition to the tax. One reason was that the timing was highly effective, as the tax was introduced early on in the history of mobile telephony, when use remained relatively less common and when consumers remained focused on the enormous benefits relative to the use of landlines. In addition, the new revenue was officially earmarked for micro-finance initiatives, rural electrification and HIV/AIDS programs, all of which were popular with the public and, as importantly, parliament. Yet, while the earmarking strategy was effective for selling the tax, there is great uncertainty about whether all of the resources were ever, in fact, used for those purposes.

7.1.8. Political Liberalization and Economic Recovery 2003-2007

The elections at the end of 2002 brought President Mwai Kibaki to power as the leader of a unified national opposition under the banner of the National Rainbow Coalition (NARC). The new government ushered in a period of unprecedented, if still very imperfect, political openness, with the Freedom House indicators of political and civil liberties jumping by three and two points respectively between 2001 and 2003. These changes, coupled with improved external economic conditions and renewed dialogue with donors, facilitated a major economic recovery. While fissures in the ruling coalition emerged dramatically in 2005, progress during the first three years under the new government was notable.

These broad improvements were reflected in exceptional improvements in tax revenue collection, which expanded from 15.7% of GDP in 2001-02 to 21.8% of GDP in 2004-05. The period did not witness any major tax policy changes, and the major revenue gains are thus attributable to the economic recovery and to improved collection of existing taxes.

Improved compliance was attributable in large part to significant administrative reforms, which were, in turn, the product of high-level political commitment. These reforms included the functional integration of the different tax departments within the KRA, a new cross-cutting staff training program, the increasing use of computers, and a dramatic new emphasis on Results Based Management and the attainment of revenue targets. These administrative reforms were coupled with an informal understanding that the new government was significantly less willing than its predecessor to countenance tax evasion by its allies (Moye and Ronge 2006).

Political commitment to these reforms appears to reflect four factors. First, the government was confronted with a significant fiscal deficit. Second, this fiscal deficit made the government relatively beholden to donors, and the government was eager to reduce this reliance given a long history of antagonism. Third, the government had made large spending promises during the elections, most notably to provide free primary education. These commitments all required additional revenue. Finally, many of those close to the process attribute it to the fact that Kibaki was a technocrat, committed to effective management, whereas Moi's more populist instincts had made taxation less of a priority.

Equally important to revenue gains was the public goodwill that greeted the new government, as this goodwill increased the willingness of taxpayers to comply and improved morale within the tax administration. In fact, increases in public revenue often appeared to be as much a source of public pride as of popular anger, regularly appearing prominently in the major newspapers and in speeches by politicians. Public interest in revenue collection is widely noted by those within the tax administration, and is reflected in the fact that the huge revenue gains during the period elicited very little public resistance. A tax officer explained that, "the biggest thing is that there is renewed goodwill towards the government...this has made it much easier to extract revenue from taxpayers". Tax officials likewise explain that when disagreements emerged within the ruling coalition in 2005, tax compliance simultaneously declined, and this is reflected in reduced levels of tax collection in 2004-05 and 2005-06.

Not only did the NARC government benefit from public goodwill, it sought to explicitly connect its popular initiatives with the drive for increased tax revenue. This was true of the provision of free primary education, and was likewise true of the creation of Constituency Development Funds (CDFs), which were introduced in 2003 and earmarked 2.5% of total ordinary revenues for local development projects under the leadership of local MPs. Despite concerns about the mismanagement of the CDFs, they achieved significant public notoriety and popularity and were an obvious way to ensure the support of MPs for revenue measures (Kimenyi 2005). Particularly interesting was a government effort to link tax compliance to the more amorphous goal of achieving aid independence, as reflected in the KRA slogan “*Tulipe Ushuru, Tujitegemee*” – paying tax is earning independence. While the practical impact of aid independence on citizen welfare is difficult to assess, it is clear that the call for aid independence achieved public resonance, and thus aided tax collection.

Aside from this broad story, various tax episodes with smaller revenue implications provide useful insights into the politics of taxation during the period. Most of these cases point to the weakness of public resistance to taxation, and the relative absence of direct tax bargaining. In July 2003 the government increased the excise tax on mobile phone usage from 5% to 10%, but, as was the case in 2002, public opposition was largely restricted to the mobile operators themselves (GSM Association 2007). The 2006 Budget Speech included an almost 50% increase in the RML, but resistance was again muted due to genuine public interest in road maintenance and the inability of transport operators to mobilize public support. The only major hurdle to passing the new tax was parliamentary approval, and this was achieved through an earlier decision to decentralize part of the funds for use in the upkeep of local roads. Similarly, a Turnover Tax, which imposed a 3% tax on the turnover of small and informal sector firms, was passed in parliament in 2007, and introduced in early 2008, apparently in response to demands from larger firms for greater equity in taxation. While the implementation was slowed by an apparent lack of enthusiasm at KRA, which had long viewed the costs of collection as excessively high, the passage of the bill was never subject to organized resistance from a significant segment of the business community.

A government decision to require the use of Electronic Tax Registers (ETRs) in all VAT registered shops was the one tax episode that spurred significant public opposition, but nonetheless yielded little in the way of tax bargaining. The ETRs were expected to reduce the scope for tax evasion by creating an inalterable record of every transaction. The drawback was that compliance costs were meaningful, including purchase and maintenance of ETRs, additional bookkeeping requirements and difficulty in dealing with refunds. These concerns, along with a general desire to avoid tighter tax enforcement, led traders, under the umbrella of the newly formed United Business Association (UBA), to engage in large-scale protests in Nairobi, Mombasa and Kisumu, and to bring lawsuits against the government.

Yet, despite substantial resistance, the government offered neither concessions nor compromise, as it retained popular support outside of the protesters. This was largely attributable to the political goodwill that continued to sustain the government, as there is a widespread belief that the same reform could never have succeeded under the Moi government. The inability of the UBA to garner public support was further exacerbated by the fact that members quickly came to be labelled tax evaders, which, in turn, was facilitated by popular perceptions of the protesters as a “group of Asians” (despite having an African chairman). Thus, as had been the case in the 1960s and 1970s, the implementation of new taxes was facilitated by the perception that the weight of taxation would be borne by the economically privileged minority.

While most of the population thus remained relatively unable, or unwilling, to mobilize against taxation or to engage in tax bargaining, events from 2006 onwards provided further evidence of the power exercised by elites. The 2006 Budget Speech announced two measures that would specifically affect elites: the taxation of the very large non-salary benefits enjoyed by MPs and the reintroduction of the capital gains tax, which had been suspended in 1985. These two measures, and particularly the tax on MPs, enjoyed overwhelming public support, but were nonetheless rejected by parliament. Voters vowed that they would punish the intransigent MPs at the ballot box and there was, indeed, enormous turnover of MPs in the 2007 elections. There was thus some expectation that

when the taxation of MP benefits was reintroduced in the 2008 Budget Speech MPs would be forced to accept the measure. Yet, in spite of public outrage, MPs again rejected the measure, while the reintroduction of the capital gains tax was not even proposed.

7.1.9. Political Crisis and the Elections of 2007

The elections at the end of 2007 resulted in accusations of electoral fraud and the outbreak of widespread violence along ethnic and political lines. With both sides initially refusing to make concessions the violence continued unabated for over a month, killing at least a thousand people and displacing more than half a million. The violence and political uncertainty in turn prompted a growing economic crisis as businesses shut down, tourism ground to a halt and investment ceased.

While taxation did not figure prominently in the political conflict, the course of the conflict sheds light on the impact of tax reliance on broader political outcomes. The crisis led the business community to emerge as a powerful voice in favour of a settlement, and as the crisis wore on business leaders used the threat of refusing to pay taxes to prod the political leadership towards a resolution. While those involved cannot say with certainty how large a role this threat played, there is a general sense that pressure from the business community was important. More generally, it is clear that the economic costs of political stalemate, including the potentially crippling impact on government revenue, increased the urgency with which political leaders sought a resolution.

7.2. Taxation, Responsiveness and Accountability in Kenya

The most striking feature of the political economy of taxation in Kenya is the relative complexity of reform processes. Rather than comprising a set of discrete, well-defined changes, tax reform was often continuous and gradual, while collection experienced significant ups and downs over time. This makes the analysis of tax reform more complex, and requires an attention to both direct and indirect forms of tax bargaining.

The remainder of the analysis proceeds in three parts. The first section presents a more detailed discussion of the relative absence of cases of direct, explicit, tax bargaining. The

second section argues that despite this, indirect tax bargaining, through tax resistance and the growth of civil society, has been important to the expansion of responsiveness and accountability. Section three presents a series of factors that can account for the pattern of tax bargaining observed in Kenya.

7.2.1. The Absence of Direct Tax Bargaining

In Kenya there has been very little public conflict over taxation, and even less evidence of direct tax bargaining between taxpayers and governments. One very well placed policy maker put it plainly, explaining that, “I have always been very surprised that Kenyans don’t take more interest in tax issues, but they simply do not”.

There has been an absence of meaningful public engagement during several periods of significant tax reform. From 1993-1996 total levels of tax collection, especially of income and corporate taxes, increased dramatically. While increasing collection was partly the result of strong economic growth, it is accepted that tax enforcement was improved significantly. Yet, despite these new tax burdens there were no sustained public protests nor is there evidence of significant tax bargaining and conflict behind the scenes. Even more notable was the absence of public mobilization around the introduction of the VAT. The VAT was introduced in the midst of elevated political tensions and mass political mobilization surrounding demands for democratization, but there is scant evidence that the new tax became a rallying point for the opposition. This stands in sharp contrast to the role of the VAT as a catalyst for broad based political mobilization in Ghana at a similar moment in its political history. Finally, major increases in fuel prices and fuel taxes have likewise rarely been a source of significant political conflict, despite their broad impact and high level of visibility. This was particularly true in 1994 when both prices and taxes were increased, but no major public mobilization ensued.

One exception to the absence of taxpayer mobilization around tax issues was the emergence of large-scale protests against the introduction of ETRs, but this resulted in neither the repeal of the law nor concessions by government. Aside from this example, debates over tax policy have largely been restricted to MPs and elites who have merely sought to defend

established privileges and exemptions. The capital gains tax was successfully suspended in 1985 as the result of opposition from MPs and elites, while efforts to reintroduce the capital gains tax and to introduce the taxation of MPs' benefits were rebuffed by parliament in recent years.

At a relatively small scale there have been a handful of direct tax bargains between MPs and the Executive, but there is little evidence of significant public engagement. The most interesting examples are narrow tax bargains in which the government offered MPs greater authority over public expenditure in an effort to secure their support for broader tax collection. In seeking to expand the RML the government agreed to decentralize part of the fund, thus increasing the power wielded by MPs. Likewise, in the wake of the 2002 elections, the creation of the CDFs was an explicit response to demands from MPs for greater control over public spending, and was at least partly motivated by the broader government goal of gaining support for increased tax collection. These examples represent a modest expansion of governmental accountability, in so far as they contributed to increasing parliamentary authority at the expense of the Executive, but the absence of broader public engagement invites scepticism. For example, the new tax on mobile phone usage was initially earmarked for microfinance, rural electrification and HIV/AIDS programs, but there is no evidence that the funds were reliably allocated according to the original promise.

7.2.2. The Importance of Indirect Tax Bargaining

The relative absence of direct tax bargaining in Kenya does not similarly imply the absence of indirect tax bargaining. The ability of taxpayers to resist taxation by unpopular governments has created broad pressure for increased responsiveness and accountability, while taxation has played a role in catalyzing the growth and strengthening of civil society. What follows presents evidence of both processes.

7.2.2.1. Tax Compliance, Tax Resistance and Reform

Despite the relative absence of direct tax bargaining, or of major public conflict over taxation, it is very clear that the popularity and perceived legitimacy of successive Kenyan

governments has shaped their ability to raise revenue. Resistance to taxation has contributed to the fiscal weakness of unpopular governments, and has provided added pressure for changes in government and positive incentives for subsequent reform.

The relative inability of governments with flagging popularity to raise tax revenue was modestly apparent during the first three decades after independence. From 1975-78 the Kenyatta government experienced increasing tax collection difficulties as it began to lose public confidence. This pattern was reversed during the optimistic early days of the Moi government, as tax collection improved noticeably. As Moi's popularity declined after the mid-1980s the government again experienced increasing difficulty sustaining tax collection and closing a growing fiscal deficit. Finally, the elections of 1992, which imbued the government with some renewed legitimacy also set the stage for a dramatic period of tax reform and a major surge in revenue collection.

While tax collection thus consistently tracked the broad fortunes of governments for the first three decades after independence, the political consequences were modest as firmly entrenched governments successfully weathered the fiscal downturns that resulted from declining popularity. This began to change in the late 1990s, as tax resistance took on greater political importance. Revenues began to fall rapidly after 1997, and while this was driven to a significant degree by economic crisis, it also reflected the fact that the declining popularity of the government was eroding administrative probity and encouraging citizens to engage in tax evasion and avoidance. This view is widely shared by tax officials, and some go so far as to describe this as a semi-explicit opposition strategy to weaken the Moi government in anticipation of important elections in 2002.

The growing fiscal crisis undermined the ability of the government to implement popular public programs and reduced the capacity of the government to dispense patronage to sustain elite support. This, in turn, contributed to Moi's defeat in the 2002 election. Thus, the ability of citizens to resist taxation by an unpopular government contributed to change. Furthermore, the tax resistance that contributed to Moi's defeat also created strong incentives for the incoming government to expand responsiveness and accountability in

order to secure improved tax compliance and collection. This contention is supported by three key facts. First, the new government was responsible for substantial improvements in responsiveness and accountability by any available cross-country measure. Second, efforts to improve tax collection were facilitated by widely acknowledged improvements in the willingness of citizens to pay taxes. And, finally, there is evidence that in implementing its reform program the government was explicitly motivated by the revenue imperative, as it repeatedly sought to connect tax compliance to key aspects of the reform agenda, including free primary education, the creation of the CDFs and aid independence. Thus, there is important evidence that tax conflicts contributed to the change in government and provided significant additional incentives for reform, thus contributing to the expansion of both responsiveness and accountability.

While the events around the 2002 elections thus provide the most compelling evidence of the importance of indirect tax bargaining, a similar pattern unfolded in the aftermath of the 2007 elections. The outbreak of violence posed a major threat to Kenyan businesses, so the major business associations pushed the government for a peaceful settlement. The business community used their status as taxpayers in calling for a resolution of the political impasse by explicitly threatening to withhold tax revenue if the government failed to make peace. While there were diverse factors that contributed to the resolution of the post-election crisis, many observers feel that that role of the business community was significant, and that the need to sustain tax revenue played an important part in pushing the government towards peace. Consistent with this view is the fact that the level of tax collection returned to normal in the aftermath of the violence, following earlier fears of a fiscal crisis.

The events surrounding the post-election violence also highlight the broader argument that governments that are reliant on tax revenue are likely to have significantly stronger incentives to resolve such crises in order to avoid a fiscal emergency. The violence that followed the elections led to a major decline in economic activity, and this would eventually have generated a fiscal crisis, irrespective of the willingness of businesses to pay taxes. In simplest terms, the government could not afford to allow a protracted period of violence due to the fiscal consequences, whereas pressure for a resolution would have been

significantly reduced had the government had access to non-tax revenues that were less sensitive to conflict. While the economic costs of civil conflict are significant anywhere, they have a much more immediate impact on government when the government is reliant on tax revenue. This follows scholarship on civil war in sub-Saharan Africa, which argues that conflict is likely to subside when the combatants can no longer afford to sustain it (Leonard and Strauss 2003). This observation is neither new, nor strictly an example of tax bargaining, but reinforces the more general argument that governments that are reliant on tax revenue are more likely to be responsive and accountable.

7.2.2.2. Taxation, Civil Society and Public Engagement

Taxation has also contributed to the expansion of responsiveness and accountability in Kenya by acting as a catalyst for the strengthening of civil society. This has been true of both business associations, for whom the threat of taxation has encouraged greater engagement, and broader civil society organizations, several of which have organized advocacy campaigns explicitly focused on the rights of taxpayers.

7.2.2.2.1. Business Associations

While business associations have the potential to play an important role in supporting the expansion of responsiveness and accountability, research about business associations in the developing world has argued that in practice business associations have frequently sought narrow benefits for their most powerful members, rather than pursuing broad-based improvements in governance (Olson 1965, Goldsmith 2002, Brautigam, Rakner and Taylor 2002). The political challenge thus largely lies in shifting business associations from an essentially rent-seeking role to engaging in “constructive contestation” with government (Handley 2008: 2). In Kenya, there is evidence that taxation has contributed to such a shift.

Under President Moi, the country’s major business associations were primarily engaged in lobbying for narrow benefits rather than providing a unified voice for change. This reflected the fact that the Moi government offered significant scope for these kinds of narrow benefits. This dynamic began to change after the 2002 election in response to political opening, reduced opportunities for narrow rent seeking and the shifting burden of taxation. Whereas under Moi businesses allied with the government were able to secure

formal and informal relief from paying their full share of taxes, the increasingly aggressive, and balanced, enforcement of taxation after 2002 provided stronger incentives for business to bargain with government on a collective basis. Taxes have correspondingly remained near the top of the agenda for the large business associations, which have particularly argued for broadening the tax base. The government has made at least halting efforts to respond to this demand, and business leaders report that the increased willingness of business to comply with tax laws has been driven in part by reciprocal efforts by the government to extend taxation to small and medium enterprises.

While fairer enforcement of taxation has thus contributed to large business associations engaging more constructively with government, it has also directly catalyzed the growth of business associations representing small and medium enterprises, which were historically excluded from the larger associations. The most high profile example was the emergence of the UBA, which was founded in 2001 to oppose a government decision to require all traders to use Stock Cards, designed to monitor movements in their inventory of goods and thus curb tax evasion. The organization subsequently grew to greater prominence organizing resistance to the introduction of ETRs, and opted for further formalization and the creation of a permanent Secretariat in response to continued government efforts to improve tax collection from medium sized firms.

Taxation has also played a role in strengthening informal sector associations, including the Nairobi Informal Sector Confederation (NISCOF). NISCOF and similar associations have gained some prominence in recent years in response to political liberalization and growing government interest in engaging with the sector, driven, in turn, by a desire to expand the tax base. The Kenya Private Sector Association (KEPSA) has also supported the growth of NISCOF, with KEPSA members hoping to increase their political legitimacy and encourage the formalization of small firms. Interestingly, informal sector associations are not simply focused on resisting taxation but also in bargaining directly with government. While bargaining is highly informal, NISCOF and others have hoped to exchange greater tax compliance for the simplification of business registration rules, a strengthened political voice and greater protection from the predation of municipal officers seeking bribes. As

captured by Sheila Kamunyori (2007: 17) in her study of the association, “NISCOF was clear that street vendors would be willing to pay tax, in return for guaranteed services (or at least the right to demand these services).”

7.2.2.2.2. Civil Society and Taxpayer Mobilization

While the threat posed by taxation has catalyzed the growth and more active engagement of business associations, it has also prompted responses from a broader range of civil society organizations. These organizations have been explicitly organized around the idea that the payment of taxes entitles taxpayers to demand responsiveness and accountability from government. While these organizations have had a modest absolute impact on the behaviour of government, often owing to the unwillingness of government to make concessions, they point to the mobilizing potential of taxation and provide some indication of opportunities for future civil society engagement.

The Karen and Langata District Association (KLDA), which represents taxpayers from one of Nairobi’s wealthiest neighbourhoods, challenged the right of the City Council to collect taxes in light of the absence of any transparency or accountability. The KLDA won a court decision in 1995 that suspended the right of the City Council to collect property taxes and mandated that taxes be placed in an escrow account until the City Council had put in place appropriately transparent financial accounts. Unfortunately, this decision resulted in a stalemate rather than leading to an effective tax bargain: Taxes continued to be placed in the escrow as of the time of writing, with the KLDA demanding that it be given greater control over district development planning before releasing the funds.

The KLDA was followed by another wealthy group of taxpayers who created the We Can Do It (WCDI) campaign. The group challenged the right of the City Council to collect property taxes until such time as it could demonstrate improved accountability, and a court ruled in its favour in both 2001 and 2004. The WCDI campaign demanded that stakeholder boards be created to expand public participation in municipal management and also demanded that property taxes be based on the level of development of the property, as opposed to land area alone. Yet, as of the time of writing, there had been no compromise,

with the local government unwilling to create stakeholder boards and claiming that property valuation based on the level of development was beyond the capacity of the council (Kelly 2000).

Finally, the Kenya Alliance of Resident Associations (KARA) was founded in 1999 to connect and support residents' associations in their demands for improved government performance. While the organization has addressed a huge array of primarily urban development issues, the work of KARA is underpinned by the argument that tax payment provides residents with a basis for demanding improved performance from government. Although the organization is still relatively young, the effort to link taxation and public accountability as a strategy for mobilizing public advocacy does appear to have meaningful resonance within the forums in which the organization operates.

While all of these organizations have made some strides in linking taxation to broader demands for responsiveness and accountability, they are plagued by the fact that they have been largely unable to reach beyond relatively elite constituencies. A more recent initiative has sought to achieve this broader outreach and make demands for public responsiveness and accountability on the basis of the status of its members as taxpayers. The National Taxpayers' Association (NTA) was launched in 2007 as a joint initiative of the Centre for Governance and Development (CGD) and the UK Department for International Development. The practical focus of the NTA has been on monitoring local expenditure under the CDFs, and this objective is shared with several other organizations in the country. The agenda thus remains very expenditure focused but there is an internal desire to engage more directly with issues of tax policy and administration. More generally, one of the goals of the NTA has been to make taxpayer rights a central theme underpinning and motivating advocacy efforts and campaign organizers report significant success in this regard. To quote one leader of the campaign, "They [local residents] get really excited when you explain to them that they are actually the ones who fund the government, [and that] this can be negotiated." The early work of the NTA thus presents important, though still tentative, evidence that taxation can be a catalyst for broad-based community organizing and demands for responsiveness and accountability.

While the evolution of the NTA is very interesting, it also presents a mystery. The link between taxation and accountability appears to have significant public resonance, and is echoed by other observers. One well-placed observer notes that, “there is a huge amount of concern about tax and about how it is being used. A strong feeling that ‘this is our money.’” Yet, these claims are seemingly at odds with the history of taxation in the country, which has been characterized by relatively little conflict or public engagement. Central to this story, in the view of those involved, has been the role of the CDFs in expanding public awareness and engagement in recent years. While the CDFs were initially a concession to MPs hoping to use them to entrench their political positions, an unexpected consequence has been to raise awareness and reinforce the message among taxpayers that government funds are ‘their money’. The lesson, it seems, is that taxation can be a powerful basis for organizing public engagement when citizens are aware of the taxes that they pay and have come to expect reciprocity from government.

7.2.3. Explaining Patterns of Tax Bargaining

There is thus significant evidence that while direct tax bargaining has been rare in Kenya, indirect tax bargaining has made an important contribution to the expansion of responsiveness and accountability. This finding is somewhat surprising, as on the surface Kenya would seem to present a case in which direct tax bargaining would be particularly likely: Kenya has collected the most tax revenue of any country in the region in most years since independence, has a relatively active civil society and data from the Afrobarometer survey indicates that Kenyans are comparatively likely to support tax avoidance and evasion when the government is deemed to be unaccountable.²²

The purpose of this last section is thus to offer an explanation for the relative absence of direct tax bargaining and for the importance of indirect forms of tax bargaining. What follows presents four broad factors that help to explain observed patterns: coercion,

²² The survey asked respondents whether they agreed with the statement that, “The department of taxes always has the right to make people pay taxes”. Out of sixteen countries Ghanaians had the second highest level of agreement, while Kenya was ninth. Ethiopia, which is the subject of the next chapter, was not surveyed.

strategic government behaviour, fragmented taxpayer interests and the history of taxation in Kenya. The first three factors are focused on explaining the absence of direct tax bargaining, while the fourth factor seeks to explain both the absence of direct tax bargaining and the prominence of indirect tax bargaining.

7.2.3.1. Coercion

Despite a high degree of political stability, Kenyan politics remained relatively autocratic until the 2002 elections, with the period from the mid-1980s until 1991 being particularly repressive. When asked why there was not more of a public response to taxation throughout the period, and particularly to the introduction of the VAT in 1990, most observers first point to the general absence of political liberties. While there were large public protests leading to the introduction of elections in 1992, this mass political action stood in contrast to the special interest driven politics of the period. In the presence of relatively limited outlets for tax protest we might reasonably expect taxpayers to resort to tax evasion and avoidance rather than confronting the state directly, and evidence of high levels of evasion and avoidance in both the late 1980s and the late 1990s are consistent with such a response.

While the direct impact of coercion on levels of public engagement with tax issues cannot be directly observed, it is clear that political repression limited political debate. That said this is alone is not a sufficient explanation for the absence of direct tax bargaining. The Ghanaian case of mobilization against the VAT makes clear that taxation can be a catalyst for protest even where the government remains relatively authoritarian (Osei 2000). Furthermore, reduced political repression since 2003 has not given rise to any dramatic examples of direct tax bargaining despite large increases in revenue collection.

7.2.3.2. Strategic Government Behaviour

The second issue that is frequently proposed in interviews to explain the lack of public action around taxation is the strategic behaviour of government in introducing new tax measures. This can be broken into two areas: the importance of timing when introducing new measures, and the importance of gradualism for disarming public opposition.

7.2.3.2.1. Timing

The most ambitious tax reforms undertaken by the government occurred following the elections of 1992 and 2002, both of which were periods of relative political goodwill and of broader economic boom. The controversial capital gains tax in the 1970s followed the same pattern, as it was implemented during the early phases of the coffee boom and was pitched in part as a tax on that new wealth. Similarly, while the VAT was introduced in 1990, more controversial efforts to extend taxation to services and to rationalize the rate structure were put off until after the 1992 election. The government was thus able to take advantage of popular goodwill to push through reforms that might otherwise have been highly controversial. Once the reforms had been implemented it was, in turn, unlikely that they would be subsequently reversed, although the capital gains tax was suspended in 1985. One senior official captured this dynamic succinctly: “You need to introduce new taxes at a time of boom. That is the politics of taxation.” By observing this basic rule the government appears to have limited the likelihood of conflict and thus minimized the need for tax bargaining.

7.2.3.2.2. Gradualism

The government consistently pursued a policy of gradualism when undertaking any kind of economic reform. The broad program of economic liberalization, for example, was prominently proposed within government as early as 1982, but reforms were still being implemented in the late-1990s. This stands in contrast to many other countries in the region, which have often been characterized by rapid and clearly defined periods of reform, in part due to the demands of international donors (O’Brien and Ryan 2001).

Senior policy makers are transparent about the fact that the gradualist approach to reform has been driven by a desire to reduce public resistance. Gradualism has been a means to limit the amount of public attention given to reform programs and to ensure that the impact is spread over time and thus less likely to spark a spontaneous public reaction. While policy makers were frequently more concerned about the influence of narrow special interests than of the public at large, the reform strategy served to limit resistance on both fronts. One of Kenya’s prominent economic policy makers reports gaining a measure of infamy with international organizations for arguing that, “the more you involve people in

reform the less likely you are to achieve your goals. The less transparent you are the more likely you are to succeed”. This view seems to have been widely shared by similarly placed officials, who propose that Kenya has been characterized by “reform by stealth” and “reform by subterfuge”. Within the realm of taxation this was most apparent in the case of the VAT, as the rationalization of the rate structure, and the extension of the new tax to services, was stretched over more than six years.

7.2.3.3. The Fragmentation of Taxpayer Interests

The third issue that appears to have played a part in the relative absence of direct tax bargaining is that taxpayers have rarely presented a united response to government tax initiatives. Because of the absence of a unified position taxpayers have not wielded the political power and cohesion necessary to compel government concessions. The lack of unity among taxpayers has two notable causes. First, powerful individuals and interests have preferred to seek narrow benefits rather than seeking to bargain for collective benefits. Second, groups seeking to resist new taxation have often failed to gain broader popular support. Central to the lack of unity among taxpayers has been the extent of racial cleavages in the country, and this is discussed in detail at the end of this section.

7.2.3.3.1. Elite Fragmentation and Narrow Benefit Seeking

When confronted with taxation, taxpayers may respond collectively with other taxpayers in an effort to secure a broad tax bargain with government or may respond by seeking narrow benefits for themselves. For example, a business confronted with the increasingly assertive collection of corporate taxes may: (a) opt to work with other businesses to ensure that the government improves the business environment in exchange for tax compliance, or; (b) work through individual contacts in government to ensure that it will be spared part of the new tax burden. In broad terms, many Kenyan elites have preferred to pursue narrow benefits, thus undermining the potential for more productive bargaining between taxpayers and governments. This outcome is broadly consistent with the predictions of pioneering work by Margaret Levi (1988: 64), who suggested that governments might seek to purchase the allegiance of a small number of influential taxpayers using “side payments”, rather than engaging in tax bargaining with a broader group.

It is, of course, difficult to point directly at the narrow, and informal, privileges enjoyed by individuals and small groups precisely because those privileges are kept secret due to their illegality or unpopularity. That said, Kenya is remarkable in that the efforts of politicians to avoid taxation have often played out in the public domain. Parliament's refusal to pass laws taxing their benefits or to re-institute the capital gains tax is indicative of a class that is happy to tax others, secure in the knowledge that they will remain relatively less affected. This dynamic is similarly apparent in the poorly kept secret that, particularly under Moi, the politically well connected frequently paid less tax than they should have by law, exemplified by the consistent failure of state-controlled firms to pay taxes. In an environment in which the relatively powerful are able to pursue narrow benefits and exemptions it is little surprise that elites have historically not led efforts to catalyze public demands for reciprocity in taxation. In fact, those who enjoy privileged treatment under an existing tax system are likely to prefer to keep tax issues off the political agenda so as not to draw attention to their privilege.

As was noted earlier, such a pattern of narrow benefit seeking was equally apparent among many business elites, at least until 2003. A well-placed observer of the historical role played by the Kenya Alliance of Manufacturers, likely Kenya's strongest business association, captures this succinctly. He explains that, "a few people got what they wanted, but they did not go after a whole business agenda for manufacturing." The preference for seeking narrow benefits seems to have reflected the fact that political repression made it difficult to pursue a national agenda, while widespread corruption made it relatively straightforward to secure narrow benefits and exemptions.

7.2.3.3.2. The Absence of Popular Support

While the ability of elites to pursue narrow benefits has eroded the likelihood of unified tax bargaining, an equally important issue has been the inability of those resisting taxation to garner significant popular support. Two examples stand out: the conflict over ETRs and the absence of conflict over fuel taxes.

While major protests erupted in response to government legislation requiring the use of ETRs by all VAT registered firms, those protests were undermined by the fact that the

protesters, numerous as they were, never enjoyed broad based popular support. The government successfully labelled them tax evaders, and, in the public mind, this outweighed trader complaints about the costs of collection. This allowed the government to ignore the widespread protests and press forward with the measure without making any meaningful concessions. In similar fashion, increases in fuel prices have consistently been met with complaints from public transport operators. Yet, despite the fact that the public bears the higher costs of transport that result, the transport operators have never enjoyed broad public support in their protests against fuel taxes. It is broadly believed that this has resulted from the deep unpopularity of public transport operators, who are viewed as reckless, disrespectful and, occasionally, criminal.²³ While the inability of different groups of taxpayers to find a united voice with which to bargain with government has diverse roots, these examples make clear that the absence of unity has undermined the likelihood of tax bargaining.

7.2.3.3.3. The Role of Racial Divisions

A particularly important factor in explaining the absence of unified taxpayer interests in Kenya is the extent of racial divisions. These divisions appear to be so significant that it is tempting to consider them a distinct explanation for the absence of direct tax bargaining. However, racial difference are included within the broader question of the unity of taxpayer interests, as it is the absence of unity, rather than racial differences as such, which explains observed outcomes. Ultimately, racial differences have contributed to the absence of unified taxpayer interests in three, closely interconnected, ways: popular willingness to impose taxes on wealthy ‘others’, popular unwillingness to support resistance by those same groups, and the tendency of those factors to encourage narrow benefit seeking.

Particularly during the 1960s and 1970s the willingness of parliament, and the population, to accept rapid increases in taxation was largely driven by a belief, with significant justification, that much of the tax burden would be borne by economically dominant Asians

²³ The most dramatic evidence of this lack of popularity comes from 2004 when then Minister for Transport, John Michuki, instituted major new regulatory and safety requirements for public transport operators. The operators staged a two-week strike over the perceived high cost of the measures, and completely shut down transport in the major urban centres. Yet, as a group, citizens, despite being forced to walk enormous distances to work, continued to side with the government on the need for reform.

and Europeans. Thus the unique racial characteristics of the country help to explain the fact that Kenya established a relatively effective tax system soon after independence. While this dynamic became less explicit over time, concerns about tax evasion by Asian businesspeople remains a ubiquitous topic in discussions with tax officials, suggesting strongly that public support for effective tax administration continues to be shaped by support for taxing Asians and Europeans.

The flip side of popular support for an effective system to tax Asians and Europeans has been public unwillingness to support tax resistance and tax bargaining by those groups. This was prominently on display during the protests against ETRs, as the protesters were not only labelled tax evaders, but were specifically labelled *Asian* tax evaders, and this fatally undermined public support for their cause. The absence of public support, and the salience of the racial dimension, is more remarkable given that the Chairman of the UBA, which organized the protests, was an African and that the cost of increased prices would ultimately be borne by consumers.

Finally, there is a widespread belief that the exclusion of economically dominant minorities from politics, and their broader inability to garner public support for their concerns, has contributed to the rise of narrow rent seeking. This is necessarily speculative, but it is relatively common to hear variants on the claim that, ‘non-African businesses lack political support, and as a result their only options are to engage in tax evasion or seek individual benefits, often through bribery or collusion.’ While there is nothing to suggest that Asians or Europeans have been disproportionately involved in such activities, the fact that non-Africans dominated the large business associations almost certainly weakened their ability to pursue a broad based advocacy program by courting public support. Thus racial dynamics appear to be an element in explaining the historical tendency of business associations to pursue narrow aims, to the exclusion of opportunities for tax bargaining.

7.2.3.4. The Importance of History

While coercion, government strategy and the absence of taxpayer unity provide compelling explanations for the relative absence of direct tax bargaining, it is useful to conclude by

considering the importance of historical context in shaping outcomes. The Kenyan government is unique in sub-Saharan Africa for having maintained a long and uninterrupted tradition of relatively effective tax collection since independence. While conclusions are necessarily somewhat tentative, what follows argues that this history helps to explain both the relative absence of direct tax bargaining and the relative prominence of indirect tax bargaining. On the one hand, the long, uninterrupted, history of taxation in Kenya may contribute to reduced levels of tax bargaining by shaping expectations and facilitating tax reform efforts. On the other hand, the long history of tax collection may promote indirect tax bargaining by contributing to the strengthening of civil society and broader public engagement.

7.2.3.4.1. History, Expectations and the Politics of Reform

Lieberman (2002), among others, has argued that tax systems are highly path dependent: once successful tax reform has been achieved, it is unlikely to be reversed and thus shapes the context for future reform. Extended to the level of individual expectations, this suggests that those who are accustomed to paying taxes are more likely to view taxes as fair. By contrast, someone who has never previously paid taxes is likely to find the demand for tax revenue unjustifiable. Tellingly, this difference would not necessarily be reflected in survey answers to questions about individual willingness to comply with taxes: A person may be very hostile to paying unjust taxes, but yet consider a wide array of taxes to be just in light of previous experience. In the Kenyan context, taxpayers may be less likely to actively oppose taxation precisely because taxation has been a relatively consistent feature of life since independence, and has thus become normalized even if unpopular. Unfortunately, this dynamic is poorly amenable to empirical testing, but the intuition is certainly persuasive.

Moving away from the murky area of expectations, an established history of taxation is also likely to make future reform easier because it expands the tools available to the government as it seeks to 'sell' tax reform. For example, the major tax reforms from 1993-95 were possible, in part, because the large increases in total collection were accompanied by declining tax rates and improved customer service. Businesses that may otherwise have been hostile to increased enforcement could at least point to falling rates as a benefit of

reform. Similarly, the introduction of the VAT in 1990 included efforts to reform the hugely unpopular and burdensome system of tax refunds, while the introduction of the RML in 1994 was eased by the fact that it reduced reliance on the unpopular system of road tolls. In each case reform generated significantly more revenue than had previously been the case, but in each case the existence of the earlier taxes, and the possibility of pointing to the relative benefits of the new system, improved the bargaining position of government.

This is all particularly relevant to Kenya because it had already developed a remarkably effective tax system by the late 1970s and, despite the ups and downs of the 1980s and 1990s, that system has largely been maintained. If the arguments proposed here are correct, then this early success in raising taxation partially explains the absence of contemporary conflict over taxation. Of course, even if the lack of conflict over taxation over the past three decades were a symptom of Kenya's history, we would expect the initial introduction of effective taxation to have been subject to tax conflict and tax bargaining. Yet, in practice, the initial establishment of relatively effective taxation did not involve significant tax bargaining. At the time the afterglow of independence imbued the President with enormous moral authority, and the capacity to put a system in place without significant public opposition. While difficult to prove, President Kenyatta's success in putting in place an effective tax system during the optimistic days after independence may have actually reduced the likelihood of direct tax bargaining in the future. Unlike Ghana, where tax reform involved imposing significant new burdens on taxpayers, Kenyan taxpayers have simply continued to shoulder a long established load, without experiencing the moments of dramatic change that are often conducive to public mobilization.

7.2.3.4.2. History, Taxation and Civil Society Oversight

While there are thus persuasive reasons to believe that the long history of stable taxation in Kenya has reduced the scope for direct tax bargaining, it is equally possible that that same history has contributed to the prominence of indirect tax bargaining. Most important in this respect is the potential for tax payment to contribute to the strengthening of civil society and of oversight of government activities. Whereas short-term changes in taxation may prompt tax protests, the experience of tax payment over longer periods may contribute to higher levels of public engagement, as taxpayers seek to monitor the use of public funds.

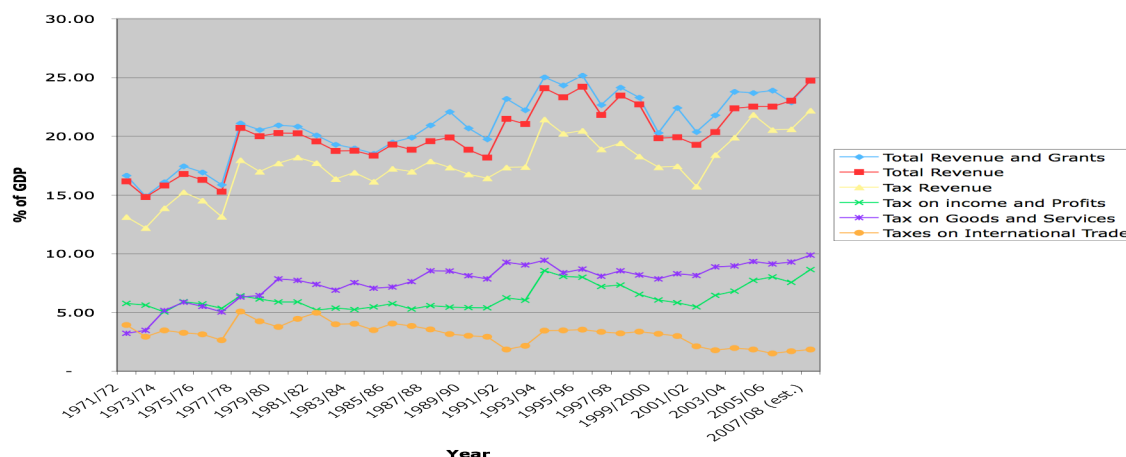
While this dynamic is virtually impossible to observe directly, it is consistent with observed patterns of engagement with tax issues in Kenya: while there has been limited tax conflict and direct tax bargaining, a number of civil society organizations, including the NTA, have organized advocacy campaigning specifically around the message that taxation can be the basis for making demands on government. These campaigns have found that their message has significant resonance, suggesting that the experience of tax payment may have contributed to longer term, but largely unobservable, changes in notions of citizenship and levels of public engagement.

7.3. Conclusions

The Kenyan experience advances our understanding of tax bargaining in three particular ways. First, despite the relative absence of direct tax bargaining, it provides important evidence that tax bargaining more generally has contributed significantly to the expansion of responsiveness and accountability in Kenya. Second, it specifically highlights the importance of indirect tax bargaining. Discussions of tax bargaining have instinctively tended to focus on direct tax bargaining, involving the relatively explicit exchange of tax compliance for improved responsiveness and accountability. This is most clearly reflected in existing econometric approaches to the question, which have assumed a highly linear causal process. By contrast the Kenyan experience has highlighted the importance of indirect tax bargaining, through resistance to taxation by unpopular governments and the gradual strengthening of civil society and public engagement. Third, this chapter has begun to highlight the contextual factors that appear to shape the particular character and outcomes of tax bargaining. The analysis here has focused on four factors: Coercion and the extent of state repression, specific government reform strategies, the importance of unified taxpayer interests and the role of history in shaping expectations and engagement. Collectively these factors make clear that while the central logic of direct and indirect tax bargaining is important to understanding political developments, these processes are shaped in important ways by the social, economic and political context.

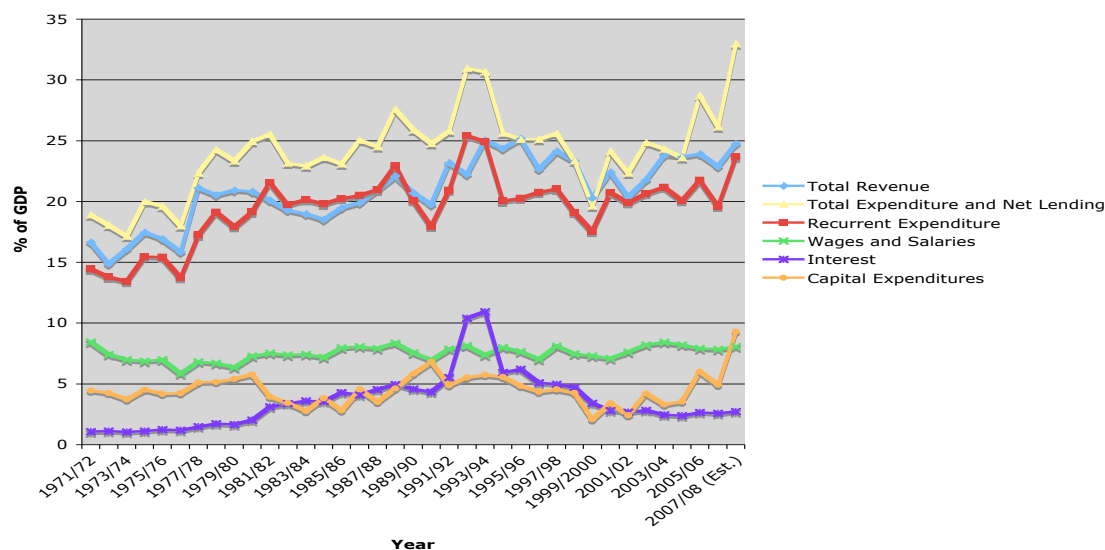
7.4. Appendix

Figure 7.A1: Composition of Government Revenue 1971-2008



Source: Revenue data is drawn from IMF Statistical Appendixes for available years, from the IMF GFS for earlier years, and from government budget data for the most recent years. Where possible the sources have been cross-referenced to ensure accuracy. GDP data is drawn from KIPPRA, the leading government research institute. This data is more reliable than data reported in the IMF IFS, as KIPPRA has revised older GDP figures to reflect updated methodologies for calculating GDP. The IMF data has not been similarly revised, and thus substantially underestimated GDP figures for earlier years. As a consequence the tax values as a share of GDP that are reported here are lower than those reported in earlier works on the subject (ie Glenday 1996) but follow similar trends and provide a more credible view of the evolution of tax collection over time.

Figure 7.A2: Government Expenditure and Revenue 1971-2008



Source: Expenditure and GDP data from the same sources used above.

8. The Quiet Politics of Taxation in Contemporary Ethiopia 1974-2008

This final case study chapter looks at the recent history of taxation in Ethiopia, building on the earlier case study of Imperial Ethiopia. The most important reason for studying Ethiopia is its uniqueness, which stems both from its long Imperial history and its experience of socialist rule from 1974-1991. This makes it possible to study the political dynamics around tax bargaining in a profoundly different context than that which has prevailed in either Ghana or Kenya, with the potential to yield important new insights.

While Ghana and Kenya were selected as case study countries owing in part to the *a priori* likelihood of tax bargaining, the factors that make Ethiopia distinctive also make tax bargaining intuitively unlikely. Four issues stand out. First, throughout the period 1974-2009 Ethiopia has remained a comparatively autocratic state. The socialist government that ruled until 1991 was exceptionally repressive, while under the current government space for public debate and competitive politics has remained sharply curtailed. Second, Ethiopia is one of the poorest, most agrarian, countries in the world, and has a significantly weaker private sector than either Ghana or Kenya. Third, Ethiopia is very heavily dependent on foreign aid. The socialist government that was in power until 1991 received significant aid, primarily from the Soviet Union, while the government in power since 1991 has received aid from the West worth an average of more than 10% of GDP annually, and reaching almost 20% of GDP from 2002-2004. Fourth, Ethiopia has had a long history of highly autocratic rule, which is reinforced by a culturally ingrained conservatism and deference to established authority, as well as the absence of a consistent history of organized public opposition and political contestation (Levine 1965: 3, Amare Tekle 1990:45-47, Clapham 1988: 21-22).

Aside from these basic social, economic and political characteristics, Ethiopia is also unique in being a federal state and in having experienced both civil war and an inter-state war with Eritrea in the recent past. Taken together these various factors make Ethiopia a compelling setting for providing new research insights. Like the preceding chapters what

follows begins with an analytical narrative of the political economy of taxation in Ethiopia from 1974-2009, and then asks what that evidence tells us about the relationship between taxation, responsiveness and accountability. Owing to the particularities of the Ethiopian political and fiscal environment the tax narrative is divided into three parts: the period of socialist rule until 1991, the period of EPRDF rule since 1991 and a final section focused on regional taxation. Data on levels of tax collection, government revenue and expenditure throughout the entire period are presented in the Appendix. As expected, we find that there has been relatively limited direct and indirect tax bargaining in Ethiopia since 1974, owing to the particular social, economic and political characteristics noted above. Yet, despite the relative absence of tax bargaining at the national level, there is nonetheless important evidence of direct tax bargaining at the regional level, as well as evidence that the ability of the government to collect tax revenue has been shaped by public perceptions. These findings suggest that while the Ethiopian context has been particularly unfriendly to the emergence of both direct and indirect tax bargaining, the basic political processes of interest remain relevant.

8.1. The Derg and the End of the Feudal State 1974-1991

Haile Selassie's overthrow in 1974 ushered in a period of profound social, political and economic change along socialist lines. In the most thorough history of the period, Clapham (1988) has argued forcefully that, for all the limitations of the new regime, the scale of change was undeniably revolutionary. What follows provides an overview of the broad politics and reforms of the revolutionary period before turning to the specifics of the fiscal evolution of the state.

8.1.1. Revolution and the Transformation of the State

Mid-level and junior military officers initially seized power in 1974 in the midst of a growing urban protest movement committed to a broadly socialist ideology. The Imperial regime had become unable to contain the growing political pressures emanating from a modernizing class of students who expressed outrage at the narrowness of Imperial rule and at the continued existence of exploitative relations in the countryside. Yet, the urban unrest remained poorly organized, which created uncertainty about who would seize the leadership

of the new movement and about the extent to which the socialist ideals of the protesters would be transformed into reality.

Over time it was military officers who progressively asserted control. Internally, the military leadership was organized into an inclusive leadership committee known as the Derg, but by 1977 Mengistu Haile-Mariam has seized unrivalled control of the Derg through cunning political manoeuvring and the removal of his major rivals through violence. Externally, two major civilian rivals, the All-Ethiopia Socialist Movement (known by its Amharic acronym, Meison) and the Ethiopian People's Revolutionary Party (EPRP), confronted the Derg. Each professed socialist ideals and a desire for civilian government, but both were largely eliminated during a period of urban terror and violence that peaked during 1976-77. The violence initially pitted the Derg and Meison against the EPRP, after which the Derg violently turned on its erstwhile allies.

Programmatically, while the Derg was not steeped in socialist ideology, it quickly adopted a broadly socialist program of action focused on nationalization and the construction of a powerful central state. The centrepiece was the announcement of land reform in 1975. The proclamation nationalized all land and called for its equal distribution among the peasantry, who were, in turn, to be organized into peasant associations (PAs). At a single stroke this sought to fulfil a central promise of the revolution and decisively eliminate the power of the traditional landed classes. While parts of the former elite engaged in armed resistance, the most remarkable trait of the reform was its popularity and the consequent speed and ruthlessness with which the old elite was swept away and replaced by the PAs. The reform served to improve the position of the peasantry, particularly in the south, and also dramatically enhanced the power of the government. Despite the differences in method, this push for greater centralization had much in common with earlier efforts dating back to Emperor Tewodoros (Clapham 1988, Bahru Zewde 2002).

In subsequent years land reform was followed by a series of policy pronouncements that were consistent with socialist ideology and a desire to expand state power. The government nationalized virtually all industry as well as a large share of urban property and housing.

Urban areas were organized into *Kebeles* (neighbourhoods), and individual *kebeles* were made responsible for local administration, land nationalization and security, the last most apparent in the role of *kebele* defence squads during the urban terror campaign. In rural areas the PAs initially enjoyed significant freedom of action, but it was not long before the government began to extend its control. By 1978 the government had seized increasing control over the marketing and transport of agricultural products and was thus able to institute tightly enforced production quotas and price controls (Ottaway 1990, Clapham 1988).

Government efforts to transform the countryside took on progressively more ambitious forms over time. The initial creation of the PAs had been accompanied by incentives for the creation of cooperatives, but this initial program proceeded gradually, and showed no benefits in terms of productivity. More ambitious was the villagization campaign that got underway in 1985. The goal was to permanently change the basic character of the countryside by relocating scattered peasant homes, which tended to be located near individual fields, into centralized villages. Despite the fact that promised improvements in service provision in these new villages often did not materialize, the implementation of the policy was remarkable, as millions of peasants literally knocked down their previous homes and moved them to new settlements. Moreover, while peasants often moved grudgingly, the power of the central government was such that villagization was largely achieved without recourse to overt violence (Cohen and Isaksson 1987, Brietzke 1976, Clapham 1988). This form of social engineering reached its climax in the government push to resettle peasants away from the densely populated, and famine prone, north. While planned resettlements were not entirely new to Ethiopia, the government resettlement of a reported 600 000 people in the aftermath of the 1984-85 famine was unparalleled, while subsequent plans to resettle an even larger share of the population appear only to have been prevented by the deteriorating position of the regime in the late 1980s (Clapham 1988).

While the government thus succeeded in building a massive administrative apparatus, and in developing the capacity to profoundly reshape the lives of citizens, it remained unable to decisively solve the problem of armed insurgency in the north. Armed resistance to the

regime emerged almost immediately in 1974, and was led by the Eritrean People's Liberation Front (EPLF) and the Tigray People's Liberation Front (TPLF). The resistance in Eritrea was unsurprising given longstanding secessionist ambitions in the region. By contrast, the resistance in Tigray was aimed at autonomy rather than independence, and reflected a deeply rooted, though more complex, regional identity. These resistance movements exercised a degree of control within their regional bases, and necessitated the continuous militarization of the country, including extremely high levels of military spending, significant military aid from the Soviet Union and periodic conscription. That said, these resistance movements did not appear to pose a serious military threat to the state as a whole until suddenly claiming the initiative after 1988 amidst evidence of the internal collapse of the Ethiopian army and state (Clapham 1988).

8.1.2. The Fiscal Basis of the Socialist State

The Derg period witnessed the rapid expansion of the role and reach of the state through nationalization, the strengthening of the administrative apparatus and significant militarization. This needed to be matched by a corresponding growth of state revenues, despite the problems that this had posed for previous governments. In practice the expansion of revenue was never sufficient to match the dramatic expansion of the state and the costs of endless warfare, and fiscal deficits began to accumulate in the 1980s. Revenue gains were nonetheless dramatic, with the difficulties of taxation in earlier periods largely overcome by nationalization and the destruction of the old elite.

Studying the political economy of taxation in a socialist state poses a particular challenge, as government control of economic activity implies that taxation is frequently hidden within the broader activities of the command economy. Extensive state control of the formerly private sector meant that tax compliance was assured, as a significant share of economic production was internal to the state. While government accounts officially distinguished between taxation and investment income, in a command economy the practical distinction would often have been merely a matter of accounting. In writing about the transition from Communism in the former Soviet Union, Gehlbach (2008: 20) clearly highlights the differences between taxation in a command economy and taxation in an open economy:

“Laying claim to funds to run the state was largely an accounting matter when most productive assets were state owned. But with privatization and liberalization, bureaucracies had to be created to locate and encourage the transfer of what was now possessed by private actors.” While remarkably little detailed information is available about taxation under the Derg, the basic message that state control internalized a significant share of taxation appears accurate. That said, there is no question that a small private sector did survive, though interviews suggest that these firms often engaged in aggressive tax evasion, owing to cripplingly high tax rates on the private sector and the general hostility of the government to private enterprise.

Within the agricultural sector taxation retained its character as a transfer from private agents to the government to a significantly greater extent. The new government eliminated earlier agricultural taxes but replaced them with a land-use tax and an agricultural income tax, which together yielded roughly 5% of tax revenue annually, which is a similar proportion to what was collected by the Imperial government. In addition to these official taxes, agricultural producers faced significant and increasing taxation through the system of agricultural price controls. In these cases precise levels of taxation were hidden in prices, but the possibility of smuggling offered peasant producers both insight into the extent of government taxation and a means of tax evasion (Dercon and Ayalew 1995). Finally, the peasantry faced significant informal exactions by local officials to support the government’s military campaigns, and this appears to have gradually contributed to disenchantment with the regime (Clapham 1988: 124-125).

With these caveats in place, and bearing in mind the serious limitations of available data, it remains possible to chart broad revenue patterns over the period. In 1973-74 government tax revenue had reached a historic high of 8.5% of GDP, while total revenue, excluding grants, amounted to 9.9% of GDP. By 1979-80, tax revenue had grown to 11.7% of GDP, with total revenues of 14.1%, while after a period of stagnation total revenue reached an all time high of 18.8% of GDP in 1988/89. These figures further exclude both on-budget grant revenue and off-budget military assistance, the former of which exceeded 3% of GDP in

several years in the 1980s. Thus, at their height, the fiscal resources available to the Derg were as much as double the highest levels achieved during the Imperial regime.

These revenue gains came from four primary sources: Business income taxes, government investment income, export taxes on coffee and excise taxes on alcohol. The excise tax on alcohol was simply a case of the government levying a large tax on a good that was easy to tax and faced inelastic demand. There is no evidence that this generated any particular political debate within the broader context of state control. More interesting is the rapid expansion of government investment income, which appears to have included profits from nationalized activities, and most notably state owned firms and urban housing, though available data does not allow for a specific categorization. A dominant source of investment income was profits retained from state run enterprises, which, unlike in most countries in the region, appear to have been reasonably efficient through much of the period. Following the nationalization of the majority of industry, much of the growth of business income tax flowed from these same firms, with the division between taxation and profits largely a question of accounting. Finally, remaining private firms also certainly contributed to these totals, though specific information is unavailable (Clapham 1998: 124-125).

The surge in export taxes from coffee reflected a combination of high global prices in the second half of the 1970s, and a long-term government decision to reduce the share of the world price that was returned to producers. After world prices returned to normal in the 1980s the Derg government held the distinction of paying a smaller share of the world price to producers than any other government in Africa. This story of the progressive erosion of producer benefits is reflective of the broader trend in agricultural prices during the period. The effect of these policies was that export taxes on coffee increased from 0.6% of GDP in 1974-75 to a high of 3% of GDP in 1977-78 before settling at close to 1.5% of GDP until 1985 (Clapham 1988: 184, Dercon 2001: 10, Dercon and Ayalew 1995).

Taking a broader view of government policy, land reform initially implied a marked increase in peasant welfare, as rural producers were freed from the exactions of landlords

and the collection of land and agricultural taxes was temporarily virtually eliminated. But it was not long before the government had replaced old burdens with new ones in an effort to finance its program of industrialization and militarization (Love 1989). This began with the introduction of the agricultural income tax and land use fee, and was followed by the more burdensome exactions imposed through price controls at below world market prices. While the case of coffee was most important to public revenue, the most notorious example was the forced delivery of quotas of grain at far below market prices (Dercon 2001: 4-6). These formal agricultural exactions were matched by the regular burdens imposed by military conscription, the need for communities to directly support their conscripts and requirements of forced labour on government projects. Overall, the peasantry, which was initially highly supportive of the new regime as a result of land reform, became increasingly disenchanted as a result of these increasing burdens, though overt protest remained virtually unheard of given the extensive repressive apparatus of the state (Clapham 1988).

8.1.3. Fiscal Dimensions of Crisis and Collapse 1988-1991

Among the most remarkable aspects of the Derg government is that it succeeded in dramatically extending the power of the state for over a decade but then collapsed both suddenly and completely from 1988 onwards. While there had been a long standing guerrilla war in the north, the Ethiopian army possessed an overwhelming numerical and technical advantage and appeared firmly in control in mid-1987. Yet, by 1990 the overthrow of the regime appeared inevitable, and it was completed with surprisingly limited bloodshed in 1991 (Clapham 1988).

The obvious explanation for this sudden collapse lay within the military itself. By 1987 morale in the military was declining after a decade of forced conscription and seemingly endless warfare, and this was undoubtedly a factor in explaining the earliest military defeats in late 1987. The situation was exacerbated when these early defeats prompted an attempted military coup, which not only further fractured morale, but also led to the imprisonment or execution of much of the senior military leadership. In the aftermath of these events the TPLF in particular made large gains against weakened government forces.

What this focus on the military overlooks is the broader fiscal collapse of the state and the consequences of fiscal collapse for the military campaign. The year 1989 marked not only a military turning point, but also a fiscal turning point, as revenue peaked in 1988-89 and began a staggeringly rapid decline the following year. In 1988-89, tax revenue stood at 11.4% of GDP and total government revenue, including grants, stood at 22.7% of GDP. Two years later, in 1990-91, those values had fallen to 8.2% and 10.8% respectively, with the latter figure being less than the level of military spending alone during the years 1987-88 to 1989-90.²⁴ Put quite simply, the government reached a point at which it simply could not afford to maintain the war effort any longer, which accelerated its defeat.

The fiscal collapse was in part the product of military losses, as lost territory implied lost tax revenue and disrupted transport networks. But this explanation is grossly insufficient in light of the small revenues collected in the north and the massive scale of actual revenue losses. Instead, the collapse of state revenue seems to have emerged from three major factors. First, grants from the Soviet Union declined substantially in 1989-90 as a result of the fall of the Berlin Wall. Second, the fiscal collapse reflected the accumulated weight of a decade of excessively large deficits and overly demanding taxation. As the fiscal needs of the regime became increasingly onerous in the second half of the 1980s the government appears to have dramatically increased retention of investment income from state owned enterprises. This eventually proved unsustainable, crippling those enterprises and government revenue along with them (Bevan 2001, Bevan and Pradlian 1994). Finally, those interviewed suggest that with morale declining, and the stability of the government now in question, the population became increasingly unwilling to bear the fiscal exactions of the government and tax compliance declined.

²⁴ Data on expenditure varies significantly across sources. Bevan (2001) estimates that defence spending over the period 1986-87 to 1990-91 averaged about 9% of GDP, while Clapham (1988) reports a speech in which Mengistu announced that military spending in 1987-88 amounted to 15% of GDP. Even allowing for some under-recording of GDP during these years, it is almost certain that total government revenue in 1990-91 was below levels of military spending alone in previous years.

8.2. Liberalization and Decentralization Under the EPRDF 1991-2008

In late 1991 the Ethiopian People's Revolutionary Democratic Front (EPRDF) officially seized power (Bevan 1994). The EPRDF was thoroughly dominated by the TPLF but also incorporated other smaller regional parties. Meanwhile, the EPLF, which had been an equal partner in the campaign to oust the Derg, did not join the new government, preferring to focus exclusively on achieving independence for Eritrea. Both the TPLF and the EPLF shared the socialist convictions of the Derg, but they were faced with the practical reality of a country crippled by warfare and deprived of the support it had once received from the Soviet Union. In response to these practical realities the new government quickly entered into partnership with the international community and embarked on a program of economic and political liberalization.

Despite the appearance of a dramatic change in direction, the new reform program was in fact very similar to that adopted by the Derg in its final years, as the previous government had similarly been compelled by crisis to face the need for reform (Bevan 1994, Clapham 1988). The more dramatic step taken by the new government was the rapid promulgation of a new constitution in 1995, which enshrined a high degree of formal decentralization and effectively confirmed Eritrean independence. Building on the highly developed administrative systems put in place by the Derg government major expenditure tasks were devolved to ten new regional governments, though the more limited decentralization of revenue collection meant that regional governments continued to rely heavily on block grants from the central government (Eshetu Chole 1994, Merera Gudina 2006, Bevan 2001). Decentralization reflected the ideological convictions of the TPLF and EPLF, as well as the practical need to resolve the regional tensions unleashed by the aggressively centralizing agenda of the Derg (Gebru Tareke 1991: 206). That said, actual policy divergence between the central and regional governments expanded very gradually, owing to the lack of policy-making capacity in the regions and the ability of the central government to exercise political control over regional governments (Bevan 2001, Assefa Fiseha 2006).

The change in government in 1991 thus brought with it dramatic economic and political changes. Since 1991 the EPRDF has remained relatively firmly entrenched in power, pursuing halting political liberalization while facilitating significant economic liberalization and renewed economic growth. What follows focuses particularly on the fiscal dimension of reform and is organized around several relatively distinct periods in the reform process.

8.2.1. The EPRDF and Economic Liberalization 1992-1998

With few other options available, the new government embarked on a World Bank and IMF sponsored structural adjustment program in 1992. Immediate economic reforms included a large devaluation of the Ethiopian Birr, the abolition of most price controls, the liberalization of agricultural marketing, significant reductions in import duties and some financial sector liberalization. The immediate result of the economic reform program, which was aided by favourable weather, was a sharp improvement in economic growth. That said, reform followed a persistently gradualist approach, consistent with government ideology, and some donors were expressing frustration with the pace of reform by 1996 (Dercon 2001, Abegaz 2001).

In many respects the most remarkable aspect of the economic transition was the rapid fiscal recovery. In general, countries emerging from civil war can be expected to achieve fiscal recovery through three channels: expanded international aid, reduced military spending and the recovery of tax revenues. The last two are generally expected to be slow and difficult processes, owing to the cost of demobilizing the military, the complexity of rebuilding administrative capacity and the challenge of establishing norms of tax compliance (Bevan 2001).

Yet Ethiopia succeeded in advancing extremely quickly on all three fronts. Foreign aid exceeded 10% of GDP by 1993, while military spending fell precipitously, from over 40% of total spending at the height of the rebel insurgency to an average of 10.8% from 1991-92 to 1995-96 (Bevan 2001). Meanwhile, tax revenue expanded from 6.3% of GDP in 1992-93 to 8.3% in 1993-94 and had reached 9.9% of GDP by 1996-97. Non-tax revenue

likewise increased rapidly owing to the recovery of state controlled industries and proceeds from privatization.

Gains in tax revenue, which were primarily from income and trade taxes, are largely attributable to economic recovery, as administrative capacity was limited, administrative reform was gradual and policy reform was largely limited to reducing income tax rates and customs tariffs. Yet, the fact that the tax administration was able to achieve a significant measure of effectiveness was remarkable in the wake of an extended civil war and a profound political and economic transition. It is attributable to the near total absence of visible political opposition, a strong bureaucratic culture and a surprising degree of administrative continuity in the midst of profound political upheavals. To take a very narrow example, the coordinator of the eventual EPRDF tax reform program had originally joined the tax administration in the 1960s under Emperor Haile Selassie.

From the perspective of rural citizens, the most significant tax reform of the period was the abolition of marketing and price controls along with other forms of forced exactions from the peasantry. While precise estimates are difficult, it is clear that the peasantry experienced an immediate and significant improvement in welfare (Dercon 2001). The experience of agricultural taxation also offers a further illustration of the resilience of bureaucratic and tax norms. The collection of the agricultural income tax and the land use fee had almost entirely collapsed in 1991-92, but by the following year, under a new government, compliance was as high or higher than ever.²⁵ Overall, the government was motivated to reduce demands on the peasantry by a combination of ideology, external pressure and a desire to secure the political support of rural citizens.

8.2.2. War with Eritrea 1998-1999

The highly successful transition to peace and stability was dramatically interrupted by the outbreak of war with newly independent Eritrea in 1998. The conflict was narrowly centred on a land dispute over the newly drawn border, but reflected a deeply rooted

²⁵ While the share of GDP accounted for by these two taxes was slightly lower than previously, this was despite the fact that there has been no increase in the nominal tax rates despite significant inflation and a large devaluation. Thus levels of compliance had likely increased, or at least remained stable.

disagreement over the extent to which Eritrea would remain closely tied to Ethiopia. Putting aside the complex roots of the conflict (Lata 2003, Clapham 1988), the issue of interest here is the fiscal consequences of the war, which involved a dramatic military mobilization that lasted until the year 2000 (Addison and Ndikumana 2003: 246-7).

Based on official government data, defence spending increased from 1.5% of GDP in 1996-97 to 9.8% of GDP in 1999-2000. This, in turn, led total recurrent expenditure to increase from just over 12% of GDP in 1997/98 to almost 20% of GDP in 1999/2000, as the government increased defence spending while sustaining spending on social services at pre-war levels. In order to pay for this massive increase in recurrent expenditure, the government significantly reduced capital expenditures and dramatically increased the size of the fiscal deficit. Capital spending fell from almost 8% of GDP per annum from 1996/97 through 1998/99 to less than 5% of GDP in 1999/2000. Meanwhile, the budget deficit rose to 8% and 8.6% of GDP during the two years of the war, after never previously exceeding 4% under the EPRDF. This vast increase in the deficit reflected not only the increase in defence spending, but also the consequences of the suspension of some donor funding in response to the outbreak of war.

Warfare has historically been a dominant motive for major tax reform, and both theory and intuition supported this expectation as the Ethiopian deficit grew rapidly (Tilly 1990, Addison, Chowdhury and Murshed 2004). However, while there is some evidence that the war motivated increased attention to revenue mobilization in Ethiopia, this impact appears to have been more modest than may have been expected. During the war the government introduced a 10% surcharge on imports, while a major tax reform, which is discussed in detail in the next section, was initiated in 2001 and led to relatively large revenue increases (Addison and Ndikumana 2003). Yet, despite the timing of tax reform, senior officials who were involved in the reform program are adamant that the fiscal pressure created by the war was not the dominant motivation. They point to the fact that extensive background work for the reform program was initiated prior to the outbreak of war. Moreover, they argue that political infighting within the EPRDF at the end of the war meant that the Minister of Finance was too preoccupied for such a reform program to have taken root if it had not

been initiated much earlier (Medhane Tadesse and Young 2003). In fact, senior officials cite significantly increased pressure from the IMF, as opposed to domestic priorities, as an essential factor in motivating the acceleration of the tax reform program, though it is possible that the war played a role in making the IMF a more forceful advocate for increased tax collection.

Why, then, did the massive deficits incurred during the war not create greater pressure for tax reform? The answer seems to lie in the fact that the long-term fiscal consequences of the war were significantly more modest than might have been expected, and this is attributable to three major factors. First, the deficits accumulated during the war, while large, were smaller than would otherwise have been the case due to an unprecedented surge in privatization receipts, which exceeded 5% of total revenue in both years of the war. Second, in 1999 Russia agreed to forgive 80% of the former-Soviet debts incurred by the Derg government as part of a broader agreement with the Paris Club of large lending nations (Martin and Johnson 2005). This amounted to \$4.8 Billion of debt forgiveness, and ensured that total debt repayments, which would have been expected to expand dramatically due to borrowing during the war, remained manageable. Finally, the end of the war witnessed the rapid resumption of high levels of foreign aid, thus helping to reduce fiscal pressure on the government.

8.2.3. Accelerated Reform 2000-2004

The period following the war was one of accelerated reform, and this was broadly attributable to the combination of changing priorities within the TPLF leadership and a more assertive stance by donors, both of which were due at least in part to new pressures created by the war. The government drew praise from international observers for reenergizing the process of economic reform and continuing to strengthen the role of regional governments. At the same time the government began to focus more heavily on infrastructure investment and industry specific incentives as it sought to pursue an economic model based on the experience of fast growing economies in East Asia. Finally, political liberalization advanced significantly as a relatively vocal opposition emerged and

it appeared that the 2005 national elections would be the first genuinely competitive national elections in Ethiopia's history.

The pace of reform was equally rapid with respect to taxation, as plans initiated in the late 1990s were progressively rolled out beginning in 2001. A combination of administrative and policy reform contributed to the growth of tax revenue from 8.8% of GDP in 1999-2000 to 12.1% of GDP in 2003-04. This revenue growth was given a further boost by a substantial increase in trade taxes in 2003-04 and 2004-05, which was driven in part by rising imports to supply growing infrastructure investment.

Administrative reform included the creation of a Ministry of Revenue that enjoyed greater autonomy from the Ministry of Finance, internal re-organization, the introduction of Taxpayer Identification Numbers, the introduction of a basic IT system and a new emphasis on taxpayer outreach and education. Notable for its absence was any effort to significantly increase salaries, as had occurred in many other countries in the region, and this reflects a commitment to maintaining established norms of equity within the civil service. Given the conformist bureaucratic culture in the country (Amare Tekle 1990: 45) implementation was predictably both gradual and without controversy. The impact of the administrative changes, and overall increasing attention to tax administration, appears to have been mixed. There were substantial jumps in both trade and sales tax collection quite immediately but income tax collection stagnated, aside from a brief spike in revenue in 2001-02 that resulted from a tax amnesty program.

The period also witnessed three major policy initiatives: the introduction of a Value Added Tax (VAT), the reform and expansion of the presumptive tax system and the introduction of a withholding tax on imports. The most straightforward was the withholding tax on imports, an administratively simple means to compel compliance with existing income taxes, although it did not have a particularly large revenue impact. It is interesting that it does not appear to have prompted any effective resistance from businesses despite the fact that it effectively enforced the pre-payment of a share of income taxes.

The implementation of the VAT was designed to be gradual, owing to the limits of administrative capacity. Beginning January 1, 2003, the tax administration initially targeted larger firms as it gradually expanded the tax net. Revenue gains during the first two years were meaningful though not spectacular, as overall collection increased by between 5% and 10% relative to the former sales tax, with most of the gains occurring through collections on imports. While there were some complaints from taxpayers, especially related to the penalties for evasion, the implementation experienced little political controversy (Arega Hailu Teffera 2004). One of the most notable features of the new VAT was that it provided significantly fewer exemptions for basic goods than the previous sales tax, thus increasing the tax burden for low-income consumers (Munoz and Cho 2004). Yet this too does not appear to have generated any significant political response. The largest controversy was over the distribution of revenue and administrative responsibility between the regional and central governments, the central government ultimately retaining the bulk of revenue as well as primary responsibility for administering the tax (Wollela Yesegat 2008).

Despite the attention given to the new VAT, it was the new presumptive tax regime that proved to be both the most important reform in revenue terms and the only measure to generate significant political controversy. Under Ethiopian law, firms are divided into three categories based on turnover: Category A above 500 000 Birr, Category B between 100 000 and 500 000, and Category C below 100 000. Category C firms are not expected to maintain detailed financial accounts, while many Category B firms similarly do not do so. Instead of being subject to income tax and the VAT, these firms are required to pay a presumptive tax on income and a 2% tax on turnover. Both are deemed to imply a reduced compliance burden, as they only require measuring total turnover. In the relatively more complex case of presumptive taxation, tax liability is assessed by estimating turnover, applying a predetermined industry-specific profit rate and then taxing the resultant profits at the standard income tax rate.

This basic system had existed prior to 2001 but had been weakly enforced in many areas owing to a lack of government commitment and problems with the system for assessing turnover, under which individual tax assessors estimated turnover on an annual basis.

Under the new system local Tax Assessment Committees, that included both government officials and local business representatives, were charged with estimating turnover every three years, in hopes of thus increasing coverage and reducing corruption and abuse (Jordan 1999). More importantly, the regional governments, which were responsible for implementing the new version of the tax, dramatically increased enforcement.

The result of the new system was that income and profit tax collection in the regions increased dramatically from 1.12% of national GDP in 1999-2000 to 1.73% in 2003-04. Tax officials are adamant that the new system also succeeded in reducing levels of arbitrariness, abuse and corruption. Yet the new system became the subject of significant taxpayer unhappiness, as tax liabilities increased dramatically, more than doubling in many cases. While these increases were generally justified according to the letter of the law, the suddenness of the increases, and the lack of explanation from government, fed public unhappiness and bred mistrust, despite the creation of the Tax Assessment Committees (Warner 2005b). Moreover, the pre-determined profit rates used to calculate tax liabilities were, by the admission of many tax officials, excessively high, and while this had been relatively inconsequential when implementation was lax, it became crippling for many business as the government tightened enforcement. Such was the level of public unhappiness in Amhara region in particular that the government began studies in 2004 to evaluate the fairness of the assigned profit rates.

8.2.4. Taxation and the 2005 Elections

The 2005 national elections were expected to be a watershed moment in the process of political liberalization, as the ruling party had permitted the emergence of an organized and vocal opposition for the first time. In practice the election became a moment of renewed political repression. While most observers believe that the ruling party legitimately received the largest number of votes nationally, unexpectedly strong opposition in Addis Ababa and the three largest regions led the government to resort to electoral fraud to guarantee its dominance. A significant part of the opposition opted for public demonstrations and a decision to boycott parliament and the government responded with widespread arrests and the violent disruption of public gatherings. As of the end of 2009

the political atmosphere remained highly repressive, with few signs that subsequent elections would offer the possibility of significant contestation (Lyons 2006, Arriola 2008).

The failed elections had major consequences for taxation. In the run up to the elections, the government sought to buy support through the provision of targeted tax concessions. It is difficult to gather information on this topic due to the reluctance of officials to discuss potentially politicized issues, but two examples were repeatedly mentioned. The first was the provision of a growing range of trade tax exemptions to favoured sectors. The government plausibly attributes these decisions to an increasingly interventionist industrial strategy, but some well-placed individuals argue that there was also a political motive. What is certainly clear is that there was a significant fall in trade tax collection in the year preceding the election, despite continued increases in imports.

The second, and more widely acknowledged, example was a decision by the government to suspend certain types of fines in Addis Ababa, most notably abolishing various fines and arrears affecting taxi drivers. Addis Ababa was the most tightly contested political district in the country, and, as a local taxi driver explained, “the government told us that they would eliminate these fines if the taxi drivers would vote for them.” Ultimately, there is a general feeling that these measures did little, if anything, to secure additional support for the government, as the tax concessions were perceived to be short-term and opportunistic. But while the concessions were of modest practical importance these pre-election concessions indicate that the government perceived a meaningful link between taxation and its political popularity, even in the absence of visible public opposition to taxation

The election results had a much more profound impact on tax collection, as the results alerted the government to its growing unpopularity. While the government turned to political repression in the wake of the elections, it also took highly visible steps to try to shore up its popularity outside the capital. The government sent officials throughout the regions to hold public consultations about the roots of public opposition. Despite their clear limitations, these forums appear to have at least provided legitimate opportunities for public

feedback, and one of the issues that emerged strongly was public unhappiness with taxation, and particularly with the new presumptive tax system.

The government immediately responded with a dramatic reduction in presumptive taxation, achieved by way of a sharp reduction in the presumptive profit rates used to calculate tax liabilities. Although presumptive taxation is formally under the control of regional governments, the reduction in profit rates was nationwide and overwhelmingly dictated by the central government. While the government had initiated an internal review of presumptive profit rates a year earlier, there is widespread agreement that both the suddenness and the depth of the rate reductions were politically motivated. This view is supported by the fact that rate cuts were frequently accompanied by significant efforts to improve public dialogue and consultation surrounding the tax, while several regions also implemented a corresponding reduction in agricultural tax rates in order to maintain horizontal equity.

While many tax administrators believed that the original profit rates had been too high, they were equally opposed to the sharp cuts, which severely undermined regional government tax revenue. Presumptive tax collection immediately declined from 1.67% to 1.17% of GDP, agricultural income tax collection fell from 0.14% to .06% of GDP and collection of rural land use fees declined from 0.13% to 0.09% of GDP. These losses amounted to almost 25% of regional tax collection, thus generating a significant decline in regional fiscal welfare (Warner et al. 2005b).

In considering the impact of the tax changes following the elections, what it perhaps most striking is their somewhat contradictory character. On the one hand, there is little doubt that the decision to reduce tax rates reflected a government desire to garner public support, as the tax cuts were fiscally significant and were spread across the majority of the low and middle-income population. On the other hand, there are reasons to believe that the changes in taxation were simultaneously an effort by the government to punish its opponents and centralize political control. Most widely accepted is belief that the reduction in regional taxes was designed in part to make the regional governments more reliant on transfers from

the central government, and thus to reduce their independence (Warner et al. 2005b). Having experienced unexpected political resistance, the central government was reasserting its control. A second issue lies in the fact that the tax changes, while reducing taxes across the board, also made regional tax systems more regressive. Changes to the presumptive tax regime reduced the overall tax burden on mid-sized (Category B) firms much more substantially than the tax burden on small-firms (Category C).²⁶ In similar fashion, the changes in agricultural taxation generally reduced collection from larger farms most dramatically, while the benefits to smaller farms were comparatively modest. In both cases some observers believe that these redistributive shifts were intentional, based on the rationale that the government wished to punish the poor, who were more likely to support the opposition (Arriola 2008). This possibility is a reminder that in some cases governments may respond to public opposition to taxation not only with compromises, but also through implicit or explicit threats.

8.2.5. Post-Election Revenue Shortfalls 2005-2007

While changes in regional taxation were the most explicit tax event of the post-election period, they were part of a much broader revenue downturn that appears to be attributable to the elections. Overall tax revenue declined significantly from 12.6% of GDP in 2003-04 to 10.2% in 2006-07, thus reversing many of the gains of previous years. Declining revenue resulted from a continuous decline in direct tax collection, stagnation in domestic VAT collection and a marked decline in the collection of import VAT and customs duties. While the revenue downturn undoubtedly had multiple causes, interviews suggest that it was at least in part the result of government reluctance to crack down on tax evasion in the aftermath of the elections.

²⁶ While the change in presumptive tax rates applied equally to both medium and small firms, the aggregate effect of this change was to make the taxation of firms more regressive. The reason is that SMEs are subject to two major taxes: a flat 2% tax on turnover and the progressive presumptive tax on profits. By reducing the relative importance of the presumptive tax, the progressivity of the business tax system as a whole was sharply reduced, implying that much of the benefit of the tax change flowed to relatively better off mid-sized businesses.

In accounting for revenue performance that fell short of expectations, observers can certainly point to explanations grounded in technical barriers to collection. One prominent issue is the simple lack of funding for tax administration. In the case of the VAT, which is indicative of a broader pattern, Arega Hailu Teffera (2004) points to the fact that funding for administration is estimated to be less than 0.8% of total collection, which is significantly below the level of 1-2% recommended by international tax experts and provides limited resources for audit functions in particular (Wollela Yesegat 2008: 14). While committed administrative effort was sufficient to overcome limited resources for a time, administrators argue that the lack of capacity became an increasingly severe problem as the number of taxpayers increased. Wollela Yesegat (2008) further points to problems related to the distribution of administrative responsibility between the central and regional governments, particularly after regional governments were granted greater responsibility for VAT collection beginning in 2004. Finally, the period in question witnessed a significant increase in tax incentives and exemptions, which further helps to account for falling rates of VAT and trade tax collection.

Yet while such technical explanations are important, the magnitude of the revenue decline demands consideration of political factors. At a basic level the expansion of exemptions, while officially motivated by the need to provide incentives for investment and growth, almost certainly also embodied political motives. More strikingly, a senior tax official explains that, “after the election they told us you cannot take all the people to court...[As a result] taxpayers got relaxed...they knew that we were not in a position to enforce it the way we did before.” This reduced the aggressiveness of enforcement is consistent with the government response to unhappiness with the presumptive tax, and offers a more complete explanation for the sharp fall in tax collection.

In addition to these factors, there is also a widely held belief that the government had tried to extend its political control over the tax administration. In the aftermath of the election a major administrative reorganization was ushered in as part of a broader government program of Business Process Reengineering. The domestic taxation and customs departments were brought together under the Federal Inland Revenue and Customs

Authority, which replaced the Ministry of Revenue. This was accompanied by efforts to merge activities that were being duplicated, reorganize business processes along functional lines, reassign large portions of the existing staff and train a large group of recent university graduates to join the administration. The motivation for the program was largely technical, but it is also widely believed to have had political undertones as the government sought to reassert bureaucratic control after the elections. Regardless of the actual politicization of the reform program, the impression of politicization appears to have made administrators particularly cautious, which, along with the general disruption caused by rapid and centrally mandated reorganization, has weakened the effectiveness of administration.

While officials are very guarded in discussing the impact of the elections on the activities of government, the overall body of evidence suggests strongly that political considerations must figure prominently in explaining falling tax revenue. It seems relatively clear that businesses took advantage of the reticence of the government to aggressively pursue tax evaders and that political turmoil undermined the effectiveness of administration. It is more difficult to ascertain whether political alienation reduced the willingness of taxpayers to comply with taxation, but sharply declining revenue in the absence of a clear explanation is certainly indicative of that possibility. While political opposition was sharply repressed in the aftermath of the election, perhaps the strongest evidence of quiet resistance to taxation lies in the fact that the government avoided adopting significant new tax revenue measures despite a marked deterioration in its fiscal position, and significant external pressure for reform.

8.2.6. Renewed Revenue Focus 2008-09

Following a period of declining tax collection after the elections the government began to refocus attention on revenue issues from the beginning of 2007. The profit rates used for calculating presumptive tax liabilities were increased, though to a level still below that which existed before the election, while all of the highland regions of the country also increased agricultural tax rates during the period.²⁷

²⁷ The process of central data consolidation often takes several years, and thus precludes providing data on the overall impact on collection.

More generally, the highest levels of government began to pay increasing attention to taxation. The first highly visible step was the reintroduction of the import surtax, initially introduced during the war with Eritrea, in 2007. In late 2008 the government issued an official proclamation about the need to increase collection from large and small taxpayers alike, with a special focus on the largest 13000 taxpayers. While details of these plans remained limited, November 2008 saw parliament pass new laws that significantly expanded the power of the tax administration to use penalties, coercion and required withholding in order to collect the VAT. Throughout late 2008 and early 2009 there was growing evidence that the government was, in fact, being far more aggressive in collecting the VAT in particular and the earlier fall in revenue began to be reversed.

This resurgence in government attention to taxation from 2007 onward can be attributed to changes in the political environment and to the deteriorating finances of the government. Politically, the turmoil surrounding the elections had subsided, and, more importantly, the opposition had been decimated. With the opposition weak and divided, and public discontent more generally largely silenced, the government appears to have felt more secure in seeking to reinvigorate tax collection. Even a decision by the government to dramatically increase fuel prices in late 2008 produced little, if any, overt public backlash despite its wide incidence and high visibility. Meanwhile external pressure from donors for increased tax collection has been mounting in response to significant fiscal deficits. The Ethiopian government has developed a reputation for resisting donor demands in the belief that aid will ultimately be forthcoming regardless, but there is evidence that donors may be becoming more assertive at the same time that reduced tax revenue is making the government more dependent on aid revenues.

8.3. Regional Government Taxation

Ethiopia is distinguished from the rest of sub-Saharan Africa by the fact that there has been a significant degree of revenue decentralization, with regional governments collecting upwards of 25% of total taxes. For example, small business taxation is a central government matter in both Ghana and Kenya, but is administered by regional governments

in Ethiopia. This makes it possible to draw on comparisons across regions in order to highlight important aspects of the political economy of taxation.

This research has therefore included limited case studies of Amhara and Tigray regions, Amhara because it has been the site of the most pronounced tax controversies, Tigray because it is home to the TPLF, which dominates the ruling EPRDF party. These case studies, and the comparisons between them, shed light on five major issues: the centrality of political allegiance to tax compliance, the local nature of tax politics, the importance of implementation strategies, the limits of central government commitment to tax collection and the politics of land taxation.

8.3.1. Political Loyalty and Tax Performance

Theory predicts that citizens that feel a stronger connection to their governments will be more likely to comply with taxation, and that administrators that feel greater loyalty to the government will be more effective (Lieberman 2002, Kasara 2005). This prediction is borne out by comparing Tigray and Amhara regions.

Through its domination of the EPRDF, the Tigray-based TPLF effectively dominates all of the regional governments. And, as expected, Tigray appears, within the limits of available data, to be the most effective tax-collecting region in the country. Moreover, anecdotal evidence suggests overwhelmingly that local leaders and politicians in the region are uniquely successful in mobilizing non-tax community resources for local development projects. By contrast, Amhara region was the centre of power in the country during the later Imperial period but is now politically dominated by the EPRDF. This has led to a high degree of resistance to the ruling party, as reflected in relatively strong electoral support for the opposition in the 2005 election (Arriola 2008). This tension is reflected in patterns of taxation, as Amhara region has been a relatively poor tax collector throughout much of the period since 1991. This began to change with the arrival in 2000 of a new regional governor who was deeply committed to improving tax collection, but Amhara region subsequently became the site of the most virulent opposition to the new presumptive tax regime.

8.3.2. Community Contributions, Taxation and History

One of the more remarkable features of tax collection in both regions, and particularly in Tigray, is the widespread belief that citizens are more willing to contribute significant resources – both cash and in kind – to locally controlled community development project than to the payment of taxes. Even more striking is the belief that local politicians are likely to encourage citizens to contribute to such projects rather than paying their taxes, thus eroding the political will for more aggressive tax collection. At a general level this seems to point to the absence of confidence among taxpayers that tax payments to the regional government will result in corresponding local benefits, and this pattern of reliance on community initiatives funded by voluntary contributions is repeated elsewhere in sub-Saharan Africa (Guyer 1992, Chazan 1983).

The fact that Tigray is particularly well known for its community development projects is rooted in history. Tigray has long maintained a strong sense of regional and sub-regional independence (Levine 1965: 2). Local rulers were very autonomous throughout Ethiopia's long history and often displayed limited loyalty to the centre in times of turmoil. More recently, Tigray was persistently resistant to Haile Selassie's rule, as exemplified by the *weyane* rebellion, and was the site of continuous guerrilla warfare against the Derg regime. The guerrilla war fostered not only a sense of regional autonomy but also a culture of self-reliance, and it is this element of local history that seems to explain the high level of community contributions as well as the preference for locally controlled community development projects. In a region where the central government has often been regarded with suspicion a strong culture of self-reliance persists, even as the rise to power of the TPLF has encouraged a willingness to comply with regional taxes as well (Young 1997).

8.3.3. Reform Strategy and Public Responses

One of the most dramatic differences in taxation between the two regions is their divergent experience of the new presumptive tax regime. Despite the absence of public protest, which has rarely been a feature of Ethiopian politics, the presumptive tax regime became hugely unpopular in Amhara region and a political liability for the government. By contrast, the new tax was introduced with little public opposition in Tigray. While the

generally more cooperative relationship between government and citizens in Tigray certainly played some role, those involved strenuously point to the importance of implementation strategy. Amhara was the first region to implement the new tax and did so particularly aggressively, leading businesses to frequently experience 100-300% increases in their tax payments. Public opposition became particularly acute because the change was sudden and lacked transparency. So severe was public opposition that after the election the regional government provided tax refunds, amounting to 11 million birr (US\$1.1 million), to all of those taxpayers who had been over taxed relative to the reduced rates introduced in 2005. By contrast, tax administrators in Tigray emphasize their explicit and successful efforts to avoid Amhara's fate by introducing the reforms slowly, engaging in extensive public dialogue and involving important stakeholders like the local Chamber of Commerce.

8.3.4. The Weakness of Government Commitment to Taxation

Tigray is also unique in that it has experienced dramatic revenue volatility, which raises questions about the commitment of the central government to revenue enhancement. From 1995-96 to 1997-98 the region experienced a short-lived but dramatic surge in tax collection, primarily in the area of indirect taxes. The revenue gains resulted from the use of regional border posts to monitor trade, thereby creating a database of information for identifying tax evasion. Yet the policy was reversed in 1998, officially due to concerns about disrupting transit, increasing business costs and creating opportunities for corruption. While these are valid explanations in principle, it is surprising that the impetus for the change came from the federal government and in spite of protests by local revenue officials. Without passing judgment on the policy reversal given the difficulty of accessing information, it minimally suggests that revenue considerations were secondary to local business concerns, while it may point to the politicization of tax compliance in the region, which is home to much of the national political leadership.

8.3.5. The Politics of Agricultural and Land Taxation

Moving away from a strict comparison of Amhara and Tigray, it is useful to conclude this discussion of regional government taxation by looking in more detail at the experience of agricultural and land taxes. In most countries in sub-Saharan Africa agricultural and land

taxes are poorly enforced, owing to the lack of administrative capacity and the likelihood of aggressive public resistance. By contrast, successive Ethiopian governments have maintained an extensive system of land taxation and, remarkably, this system does not appear to have been a source of significant contemporary political conflict.

The absence of political conflict is, undoubtedly, partly explained by political repression and the inherited legacy of government control. At the simplest level peasants dare not challenge the government, which controls access to nationalized rural land. This implicit connection between tax payments and land rights dates to Haile Selassie's tax reform efforts in the 1940s. A tax officer from the Imperial government explains that, "peasants thought that the tax slip was for the land – that this slip recognized their control of the land. So they were willing to pay." This mindset has persisted to the present, despite changes in government and land tenure rules. Reporting the results of a survey of peasant farmers, Kassahun (2006: 19) explains that, "all responding farmers confirmed that paying land tax is unquestionable. The annual payment implicitly grants a land security where their name as land owner is updated on the government's master document."

Related to this connection between tax payment and land rights is a broader sense that under Haile Selassie land and agricultural taxes became a part of peasant efforts to claim rights as citizens. Bahru Zewde (1991: 192) has argued that as a result of the expansion of taxation, "the term *gabbar* lost its exploitative associations and assumed the more respectable connotation of taxpayer." An official from the period explains that paying tax "was a matter of existence," as it allowed the peasantry to connect themselves to the Emperor and the national community. Another official explains that during the reign of Haile Selassie, "rural people carried their tax receipt like an identity card." A third official proposes that the tax "was a recognition and they wanted that recognition – before, they were the property of the landlord." While these officials believe that this connection between tax payments and citizenship has been eroded over time, it appears to remain relevant.

8.4. Taxation, Responsiveness and Accountability in Contemporary Ethiopia

Having presented this extended narrative of the political economy of taxation in Ethiopia since 1974, the pertinent question is whether it constitutes evidence that tax bargaining has played a role in the expansion of responsiveness and accountability. Ultimately, the evidence suggests that tax bargaining has played a comparatively small role in shaping political outcomes in Ethiopia: not only has direct tax bargaining been rare, but taxation also has played little role in encouraging the growth of civil society. Moreover, while there is evidence that taxpayers have engaged in tax resistance when successive governments have been particularly unpopular, the political consequences have been more muted than in either Ghana or Kenya. This finding is not entirely surprising, as social, economic and political conditions in Ethiopia all appear to militate against an important role for tax bargaining. These factors include the highly autocratic character of politics, the weakness of domestic economic forces, the heavy reliance of the government on foreign aid and a historical and cultural context that seems likely to discourage tax conflict. Thus, to a large extent, observed outcomes serve to confirm existing predictions about the contextual factors that are likely to discourage tax bargaining.

At the same time, we do observe a handful of politically significant episodes of both direct and indirect tax bargaining, and the fact that this is true in spite of all of the factors that would seem to militate against it, causes those episodes to take on greater analytical significance. With this in mind, the discussion to follow proceeds in three parts: the first section reviews the relative absence of direct tax bargaining, and of public engagement around tax issues more generally; the second section considers the more limited evidence of both direct tax bargaining at the regional government level and of indirect tax bargaining through tax resistance; finally, the third section presents a more extensive discussion of the factors that appear to have diminished the potential for tax bargaining in Ethiopia.

8.4.1. The Limited Role of Tax Bargaining in Ethiopia

The most glaring feature of the political economy of taxation in contemporary Ethiopia is the extent to which overt political conflict over taxation at the national level has been

virtually non-existent. Not only is there no evidence of direct tax bargaining; even civil society engagement with tax issues has been extremely rare, with even the major business associations playing a primarily informational, rather than advocacy, role.

This pattern is particularly unsurprising during the period of socialist rule, owing to both the repressive power wielded by the government and the hidden character of taxation in a state controlled economy. The Derg regime was remarkable in the context of low-income countries for its ability to penetrate society, even in rural areas, and thus stifle political dissent. Aside from the absence of open political contestation, there was a widespread popular belief that even private activities and views could be uncovered and punished by the government (Clapham 1988). In such an environment of total repression the absence of direct tax bargaining was a virtual certainty. As importantly, the socialist economic system placed most non-agricultural economic activity under the direct control of the state, and thus obscured the very concept of taxation. For state-owned enterprises ‘taxation’ was, in fact, little more than a book keeping matter, as the government simply claimed a share of profits as taxation. In this context there was little scope for tax bargaining as state ownership of large economic enterprises implied that it was both taxpayer and tax collector.

The situation was somewhat different in the agricultural sector, where smallholder farming continued to be the dominant form of production despite the government push for collectivization. Yet even in agriculture the strict enforcement of price controls meant that taxation was hidden in the low prices paid to producers and tax evasion could only be achieved through smuggling. Meanwhile the fact that the government had nationalized all agricultural land increased the vulnerability of the peasantry and their incentives to comply with land and agricultural tax requirements. Thus, state control of economic activity significantly curtailed the potential for both direct and indirect tax bargaining. As Easter (2008: 74) writes about tax bargaining in communist Russia and Poland, which were even further under government control, “communist states did not require a compliance strategy to collect taxes. Instead they extracted hidden taxes indirectly through the administrative structures of the command economy.” Given that taxation was embedded in the structure of the command economy, tax resistance and tax bargaining were, by definition,

intertwined with challenges to the broader structure of economic activity and economic incentives. In this context, it is difficult to distinguish grievances related to taxation from more general opposition to government control of the economy (Clapham 1988).

The arrival in power of the EPRDF brought with it a degree of political liberalization and the dismantling of the nationalized economic system. The former implied the potential for limited forms of public opposition to the regime, while the latter re-established taxation as a distinct feature of economic management, potentially subject to more direct tax bargaining. Nonetheless, public engagement with tax issues remained extremely limited, and direct tax bargaining at the national level virtually non-existent. This pattern was first apparent in the immediate aftermath of the arrival in government of the EPRDF in 1991. The new government oversaw the reorientation of the tax system towards the taxation of new private enterprises, but there was virtually no public engagement.

While the ease with which the new tax system was implemented is unremarkable given the massive changes associated with the transition, and the goodwill that greeted the new government, the absence of public engagement during a new round of tax reform beginning in 2001 is striking. During this period the government introduced a new VAT and dramatically improved levels of revenue collection by improving enforcement of trade, income and goods and services taxes. Yet the public response was muted. Most notable was the absence of a public response to the VAT, which reduced the range of tax exemptions available for basic goods and thus increased prices that directly affected the majority of the population. Finally, following declining tax collection during 2005-2007, the government substantially increased tax collection in 2008 through more aggressive tax enforcement and an increase in fuel prices, but again the changes seemed to garner limited public attention.

What is particularly noteworthy during this period is not simply the absence of tax bargaining, but the absence of engagement with tax issues among the two groups that would be most expected to take an active interest: the political opposition and business associations. During interviews members of the political opposition were universal in

arguing that tax issues had not been a significant political concern. In the case of business associations, there was a significant interest in tax issues within the Chamber of Commerce, but engagement was strictly limited to an educational, rather than advocacy, role.

The one exception to the near total absence of direct tax bargaining at the national level appears to lie in efforts by the tax administration since 1991 to increase the transparency of the tax system, with the goal of enhancing compliance. While it is tempting to dismiss these efforts given the fact that public outreach and transparency remain comparatively limited, leading tax officials speak with pride about them and are adamant that progress has been made. While these changes are specific to the realm of taxation, they hold the potential to quietly challenge the tendency towards hierarchical behaviour in public administration, and government more generally. Moreover, a transparent tax system can increase public understanding of government activities and affect taxpayer expectations of reciprocity. While it would be foolish to overstate these factors, it would be equally foolish to ignore the extent to which such subtle changes may be significant in shaping long term public engagement in a historically tightly-controlled political context.

8.4.2. The Quiet Politics of Tax Bargaining

While the absence of public debate about tax issues, and of direct forms of tax bargaining at the national level, is noteworthy, it is not entirely surprising. In the context of a highly autocratic government public contestation of government policy is unlikely. However, there are alternative avenues through which taxation has shaped broader political outcomes. While such cases have also been relatively infrequent in Ethiopia, two issues warrant attention: the importance of relatively direct tax bargaining at the regional government level and the potential for indirect tax bargaining through tax resistance.

8.4.2.1. Tax Bargaining at the Sub-National Level

While tax bargaining, and public engagement with taxation more generally, has been rare at the national level in Ethiopia, there is evidence that regional taxation has been more contentious, and has yielded important gains in responsiveness and accountability. This finding is consistent with the arguments of proponents of fiscal decentralization, who have long argued that constructive engagement between citizens and government may be more

likely when governing decisions are decentralized, and thus closer to citizens (Bird and Vaillancourt 1998).

The most important example of direct tax bargaining in contemporary Ethiopia surrounds the presumptive taxation of small businesses. When introducing the reformed presumptive tax in 2001 the government stressed that Tax Assessment Committees, comprised of members of both government and the business community, would conduct assessment of the tax. This appears to have been a pre-emptive concession aimed at curbing public opposition to the new tax by increasing public participation and oversight. Yet, even with the establishment of the Committees, increased enforcement of the tax generated significant unhappiness among taxpayers.

While the absence of a culture of public protest, coupled with the autocratic character of the government, ensured that conflict over the tax occurred relatively quietly, there is no doubt that the regional and central governments were well aware of public hostility to the tax. The government initially set up a commission to study the fairness of the new tax, but the 2005 elections led the government to believe that its popularity was being significantly undermined by public hostility to the tax. This led the government to suddenly reduce rates and also to introduce broader measures to expand public consultation, particularly in Amhara region. This included nationwide consultations conducted by the EPRDF, and since then regional governments have made continuous efforts to be more transparent in communicating with taxpayers about the need for taxation and the use of tax revenues. A senior tax official from Amhara region explains that, “[now] we negotiate with society, we discuss with society...[we explain] why the government is imposing tax on the society, [and provide] transparency to society, [with taxpayers as] active participants in the assessment process.” The same official also contends that this amounted to a process of “door to door negotiation by political leaders.”

It is, of course, important not to overemphasize the importance of these reforms. The creation of assessment committees and the expansion of transparency certainly constitute gains in accountability, but both are also relatively limited in their scope. That said, there is

a sense among at least some stakeholders that the expansion of consultation and transparency around taxation may be an important force in changing the political expectations of citizens. Increased transparency stands to increase public expectations about the connection between taxation and public services, while in a broader sense these reforms create a modest space for political dialogue within a political environment that has remained relatively repressive and closed for centuries. In a context in which national politics has recently become more repressive, such gains, while modest in absolute terms, are nonetheless significant.

While the tax bargaining around the presumptive tax is particularly explicit, the fact that it has revolved around a regional tax on small businesses, as opposed to a national tax on larger firms, points to the potential importance of such smaller taxes for prompting direct tax bargaining and public engagement. The experience of taxation in pastoral regions reinforces that broad message. While the government and pastoralist taxpayers have failed to achieve an effective tax bargain, the ongoing debate highlights both the ability of taxation to prompt bargaining between taxpayers and government and the potential for tax bargaining to be an entry point for broader governance gains.

The taxation of pastoralists has long been a source of conflict in Ethiopia, though the small revenue implications have prevented this conflict from being a major political issue. The government has generally sought to tax reluctant pastoralists using a combination of movement controls, customs points and market taxes, and has justified these taxes on the grounds that pastoralists should be expected to contribute tax revenue in exchange for government services. Such controls could facilitate tax collection and aid government efforts to monitor livestock levels and establish how much tax should be collected. Pastoralists have responded to these efforts with hostility, for two reasons. First, pastoralists complain that government efforts to impose movement controls and customs points undermine the basic nature of pastoral livelihoods, which rely on mobility and adaptability. Second, pastoralists contend that the very low level of existing government services does not justify the levels of taxation being demanded.

Disagreement over movement controls and taxation has bred occasionally violent conflict that dates at least as far back as 1963, when anger amongst pastoralists at the imposition of tax-related movement controls contributed to the outbreak of the Bale uprising (Gebru Tareke 1991). In more recent years, conflict between pastoralists and state officials, including the military, has led to occasional violence and, more frequently, the seizure of livestock and other pastoralist assets. In aggregate terms the government has expended significant resources, and bred significant animosity, without achieving meaningful revenue gains. Meanwhile, the uncertainty, violence and seizures encountered by pastoralists, coupled with the absence of effective services, appear to entail costs that exceed the burden of potential taxation (Devereux 2006, Pastoralist Communication Initiative 2005, 2006, Prichard 2007).

At a gathering of pastoralists and policy makers convened in December 2006²⁸, the nature of the tax conflict was succinctly summarized by a government official: “The pastoralists are saying that they don’t receive services, so they shouldn’t have to pay tax. The government says the pastoralists don’t pay tax, so they don’t deserve services.” Both sides expressed an understanding of the potential benefits of a mutually acceptable, and conciliatory, tax bargain, but neither side has been able to overcome the antagonism that characterizes the current relationship. At the same gathering, senior pastoralist leaders provided clear indications that they would, in principle, support greater tax compliance in exchange for better services and reduced harassment by the government. One leader went so far as to ask, “If pastoralists are not paying taxes, are they in a position to demand services?” The message for this research is clear: regional government taxation, which involves direct interaction between taxpayers and the government, holds significant potential to spur tax bargaining and the benefits are potentially large. Yet, despite these potential gains effective tax bargaining can be extremely difficult in the context of deep mistrust.

²⁸ The gathering was organized by the Pastoralist Communication Initiative, and was held at the Institute of Development Studies, Brighton, UK, December 3-8, 2006

8.4.2.2. Tax Compliance, Tax Resistance and Incentives for Reform

While experience at the regional level thus provides some evidence of direct tax bargaining, it is equally possible that even where taxpayers are unable to engage in direct tax bargaining with government they may nonetheless contribute to the expansion of responsiveness and accountability through their tax compliance decisions. The case studies from both Ghana and Kenya have highlighted cases in which resistance to taxation contributed to the removal of unpopular governments and created incentives for incoming governments to adopt a reformist agenda in order to increase tax revenue. In Ethiopia resistance to taxation has been only a minor factor in changes in government, but there is compelling evidence that, as in Ghana and Kenya, levels of tax collection have fallen in response to growing popular unhappiness with the government. This provides further evidence that over the long-term tax resistance by unhappy taxpayers may contribute to the removal of unpopular governments and to producing positive incentives for greater responsiveness and accountability in states that are reliant on tax revenue.

The first Ethiopian example relates to the overthrow of the Derg government, which was accelerated by a fiscal crisis to which tax resistance was at least a minor contributor. While the immediate cause of the fall of the government lay in declining morale and military defeat, the collapsing finances of the state shaped that military outcome. While the decline of the Soviet Union as a benefactor to the government played an important role in this respect, a dramatic fall in domestic revenue figured at least equally prominently. During the final stages of the civil war, which witnessed the unexpected defeat of the government, domestic revenue fell from almost 20% of GDP to less than 9% at a time when the fiscal demands on the state were at their height. This stunning collapse of state revenue reflected the economic toll of the civil war, which had disrupted transport and caused the government to lose control of parts of the country, and the collapse of revenues from state-owned enterprises that appeared to wilt after several years in which the government directed profits to the war effort.

This narrative minimally makes clear that fiscal issues contributed to the fall of the Derg government. Had the government enjoyed access to large non-tax revenues the conflict likely would have been both longer and more destructive, and this observation speaks to the broad role of tax reliance in shaping political outcomes. Simply put, the fact that the government was reliant on tax revenue, and had limited access to non-tax revenue, hastened the end of the conflict and transition to a reformist (though still autocratic) government.

While fiscal crisis was thus essential to political change, the role of tax resistance in precipitating this crisis appears to have been modest, but certainly not negligible. Given the limited scope for tax resistance within the state owned sector, the primary evidence of tax resistance comes from the realm of agriculture. There is at last anecdotal evidence that the growing unpopularity of the regime, and its efforts to extract ever more revenue to sustain the war effort, met with increasing resistance in rural areas (Webb, Braun and Yohannes 1992: 63). This is reflected in declining collection of agricultural and land taxes in the last years of the war, as well as by a sharp decline in official coffee production during the same years, which suggests the possibility that smuggling was also increasing (Dercon and Ayalew 1995: 1799). More speculatively, the fact that the government also relied heavily on informal exactions from the peasantry to support its military campaigns suggests the possibility that resistance may have played an even greater role in exacerbating the crisis, but detailed information is, unfortunately, unavailable. Thus, we have evidence that fiscal crisis played an important role in the fall of the Derg, and that tax resistance played at least a small role in this process. This indicates that indirect tax bargaining through tax resistance contributed at least modestly to the expansion of responsiveness and accountability in this particular case, reinforcing our broader faith in the relevance of indirect tax bargaining through tax resistance as a causal process linking taxation to broader governance gains.

The potential for tax resistance to act as a catalyst for political change was similarly reinforced by Ethiopian experience around the 2005 elections. While taxation was not a major campaign issue, the government came to believe that taxation was an important source of public opposition. In response the government both reduced certain tax rates and

allowed tax enforcement to become more lax in the aftermath of the election. The result was a sharp decline in the share of tax revenue in GDP in the years following the election. While taxpayers did not resist taxation in the classic sense of anti-tax protests or aggressive tax evasion, by expressing their displeasure informally and at the ballot box they nonetheless precipitated a fall in tax revenue.

While the fall in tax revenue contributed to economic imbalances, it did not ultimately lead to a change in government or force the government to expand responsiveness and accountability. The episode nonetheless provides compelling confirmation of the broader claim that public unhappiness with government frequently leads to declining tax revenue, and thus increases the *likelihood* of changes in government and of reform. In highly autocratic settings like Ethiopia, where direct tax bargaining is highly constrained, the fact that taxpayers were able to force reduced levels of government tax collection offered them an alternative avenue through which to create pressure for a change in government and for reform.

8.4.3. Explaining Outcomes: Political, Economic and Social Barriers to Tax Bargaining

The discussion so far has highlighted an important example of direct tax bargaining around presumptive taxation as well as evidence that the popularity of the government has shaped revenue-raising capacity. This evidence supports the belief that tax bargaining can be an important contributor to the expansion of responsiveness and accountability, but the broader message is that tax bargaining, both direct and indirect, has been rare in contemporary Ethiopia. Yet, as has already been noted, this is not entirely surprising, as the political, economic and social conditions that prevail in Ethiopia are precisely those that we expect to make tax bargaining particularly unlikely: significant political repression, a weak economic base, high levels of aid dependence and a long history of highly coercive taxation. What follows discusses each in turn.

8.4.3.1. Political Repression

The importance of political repression in reducing the potential for direct and indirect tax bargaining does not bear repeating at any length. Quite simply, direct tax bargaining and

the growth of civil society require space for public mobilization and public debate, and this has, for the most part, been impossible in Ethiopia, at least at the national level. Even the case of direct tax bargaining over the presumptive tax on small businesses was carried out in virtual silence, as taxpayers made their displeasure clear through informal channels rather than through significant public protest. The basic message is that in the presence of high levels of political repression citizens are likely to be forced to bargain with government indirectly through their tax compliance decisions, and there has, indeed, been evidence of this dynamic in Ethiopia.

8.4.3.2. The Weakness of the Economic Base

Potentially as important as the extent of political repression, though more difficult to capture, is the weakness of the private sector in Ethiopia. The best known models of tax bargaining have long emphasized that relatively mobile capitalists are likely to be particularly important to tax bargaining, as they are most able to wield the threat of tax evasion and avoidance (Bates and Lien 1985). As important, though less frequently emphasized in formal models, is the fact that the economic power of the private sector is likely to provide additional resources with which to challenge the state. Taken together these factors have led Moore (2008) and others to conclude that tax bargaining is particularly unlikely in poor and agrarian societies with limited bases of independent economic power. This description closely fits Ethiopia, as it is not only one of the poorest, most rural, countries in the world, but the legacy of socialist rule has meant that the private sector remains both underdeveloped and politically unassertive. This dynamic is most clearly in evidence in looking at the Chamber of Commerce, which remains divided, weak and politically cautious.

8.4.3.3. Government Dependence on Foreign Aid

Throughout the period under study Ethiopia has remained heavily dependent on foreign aid. Since 1990 Ethiopia has received an average of more than 10% of GDP annually in foreign aid, while the level of aid reached almost 20% of GDP from 2002-2004. In most years the level of foreign aid thus matched or exceeded total revenue from tax collection. Multiple authors have predicted that such high levels of aid dependence are likely to discourage tax bargaining (Moore 1998, Brautigam and Knack 2004). While existing studies have largely focused on the possibility that high levels of aid dependence may reduce levels of domestic

tax collection, access to aid is likely to also reduce incentives for governments to make concessions to taxpayers, as they have access to alternative revenue sources.

While this chapter has not focused explicitly on the impact of aid, events in the aftermath of the 2005 election point towards the possibility that aid may have reduced incentives for taxation and tax bargaining. At the time the government faced growing popular displeasure at both the national and regional government levels and responded by significantly reducing tax rates and enforcement, in an effort to purchase public support. This had significant fiscal consequences but the fiscal cost was mitigated by the fact that foreign aid continued at levels that exceeded total tax collection. In the absence of aid the government would have been significantly less able to weather the reduction in tax revenue, and thus would likely have had stronger incentives to bargain with taxpayers rather than simply reducing collection. This topic is discussed at greater length in chapter 11.

8.4.3.4. History, Expectations and Norms

Finally, Ethiopia's unique history has shaped the contemporary potential for tax bargaining. Most striking is the importance of Ethiopia's long legacy of highly coercive taxation. The absence of public resistance to the dramatic tax changes in the 1990s is widely attributed to the fact that the tax burden, while significant, was much lower than it had been under the Derg, while the space available to private business had expanded dramatically. Thus, it was the presence of an exploitative revenue system prior to 1991 that ensured a lack of resistance to later tax initiatives, which looked very good by comparison.

There is also a deeper question of whether the long history of coercive taxation may have shaped public perceptions of taxation, and the extent to which taxpayers expect reciprocity for their tax payments. If taxation is not perceived as a form of exchange, with expectations of reciprocity, then the likelihood that taxpayers will make demands for reciprocal concessions from government will clearly be sharply reduced. This possibility is raised much more frequently in Ethiopia than in other countries in the region, likely reflecting the fact that taxation in Ethiopia has particularly coercive origins, from the tributes levied by successive Emperors during the Imperial period to government controls of the Derg period. It is telling that the Amharic word, *geber*, meaning tribute, is also used to refer to

agricultural and land taxes and that the payment of land and agricultural taxes has continued to be viewed as a claim to land rights and citizenship as much as being viewed as a payment for services (Kassahun 2006).

The extent to which taxpayers may not think of taxation in terms of reciprocity should not be overstated, however. Outside observers have long been tempted to make similar claims about the ignorance of taxpayers throughout sub-Saharan Africa, but limited survey evidence has consistently found that even rural taxpayers have much stronger expectations of reciprocity than has often been assumed (Fjeldstad and Semboja 2001). While similar survey evidence is not available in Ethiopia, the question of perceptions of taxation is complex, and the evidence here very partial. That said, both interviews and intuition suggest that Ethiopian history may have made expectations of reciprocity around taxation relatively weak, particularly in rural areas, with possible consequence for tax bargaining.

8.5. Conclusions

Since 1974 successive Ethiopian governments have, for the most part, been able to achieve reasonable levels of tax collection almost entirely through the use of coercion. This was overwhelmingly true under the Derg regime, but even since the arrival of the EPRDF major tax reforms have generally been greeted by passive acceptance or tax evasion, with little evidence of direct tax bargaining or civil society engagement. At the national level neither business associations, civil society organizations nor the political opposition have engaged actively with tax issues. But while the relative absence of easily observable tax bargaining is striking, it is not particularly surprising. Social, political and economic conditions in Ethiopia present a perfect storm of factors that are expected to reduce the likelihood of tax bargaining: repressive politics, a weak private sector, dependence on foreign aid and a long history of coercive taxation.

Given that Ethiopia is thus a setting in which tax bargaining is particularly *unlikely*, the fact that there is nonetheless meaningful, if limited, evidence of tax bargaining offers support to the broader ideas being explored by this thesis. Most obviously, tax bargaining around the presumptive tax on small businesses at the regional government level was clear cut and

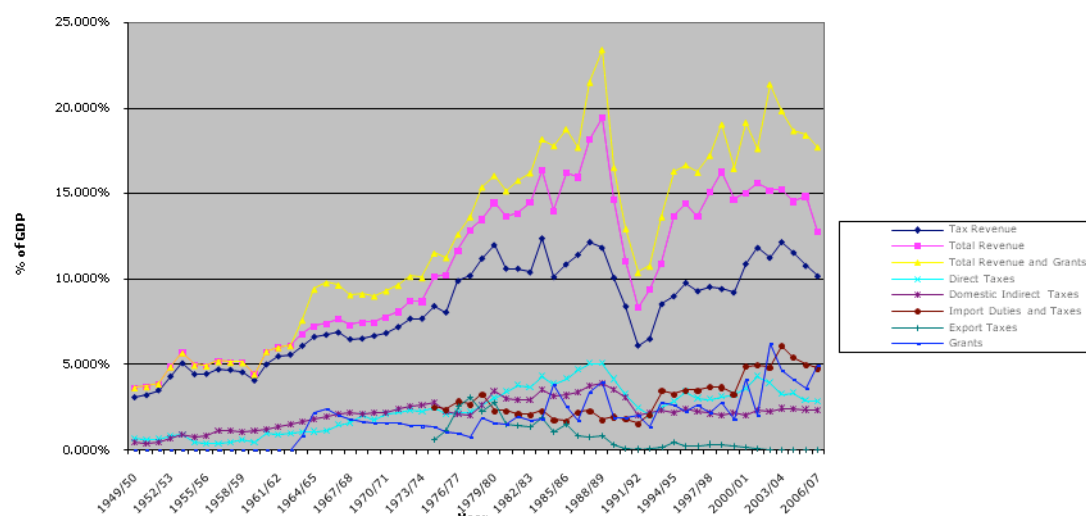
resulted in important gains in accountability in an environment in which political repression was otherwise increasing. While the gains were modest in absolute terms, in a context of such limited opportunities outcomes that create space for political engagement and for shaping political expectations deserve to be taken seriously. This is likewise true of the broader trend towards building a more transparent tax system at the national level.

As important as these examples of direct tax bargaining is evidence that the ability of the government to raise tax revenue has been shaped by levels of popular support. While falling tax revenue after the 2005 elections did not result in a change in government or in major concessions, the episode offers further support for the argument that taxpayers can exercise political power through their compliance decisions, even in a repressive political environment. Over the long-term there is every reason to believe that the ability of taxpayers to exercise such indirect political influence through tax resistance will increase the likelihood of more responsive and accountable government.

While these examples, taken on their own, would constitute weak evidence at best of the role of tax bargaining in shaping the responsiveness and accountability of government, they offer important confirmation of the importance of tax bargaining when considered in conjunction with the two previous case studies. In a repressive environment like Ethiopia the importance of taxation in shaping broader political outcomes will invariably be indirect and difficult to observe, but this chapter has made clear that the basic political mechanisms of interest are no less relevant. In doing so it has also re-emphasized the importance of context, while suggesting that sub-national taxation may be an important focus for future research.

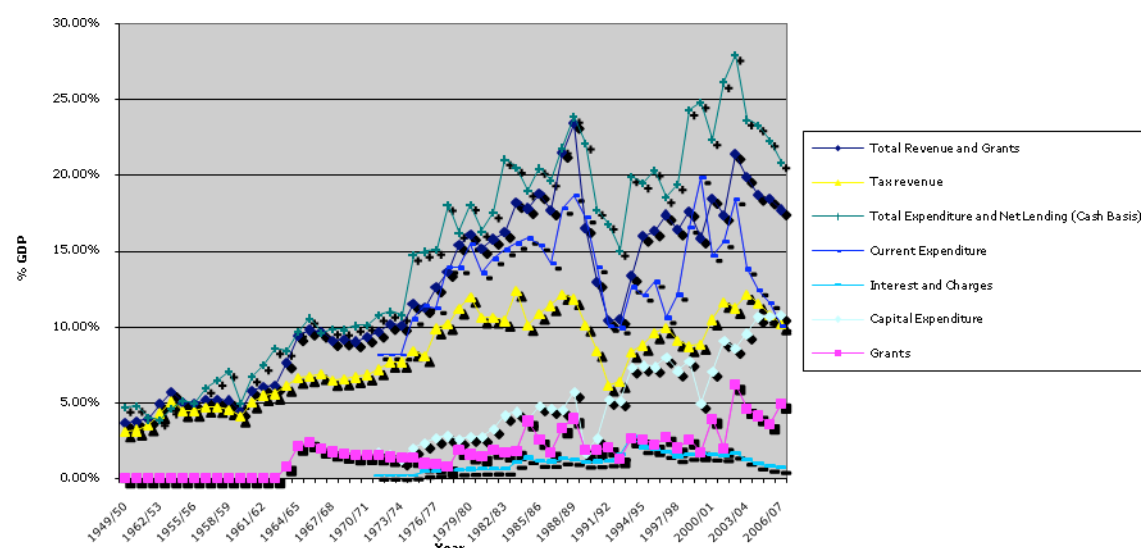
8.6. Appendix

Figure 8.A1: Composition of Revenue 1949-2008

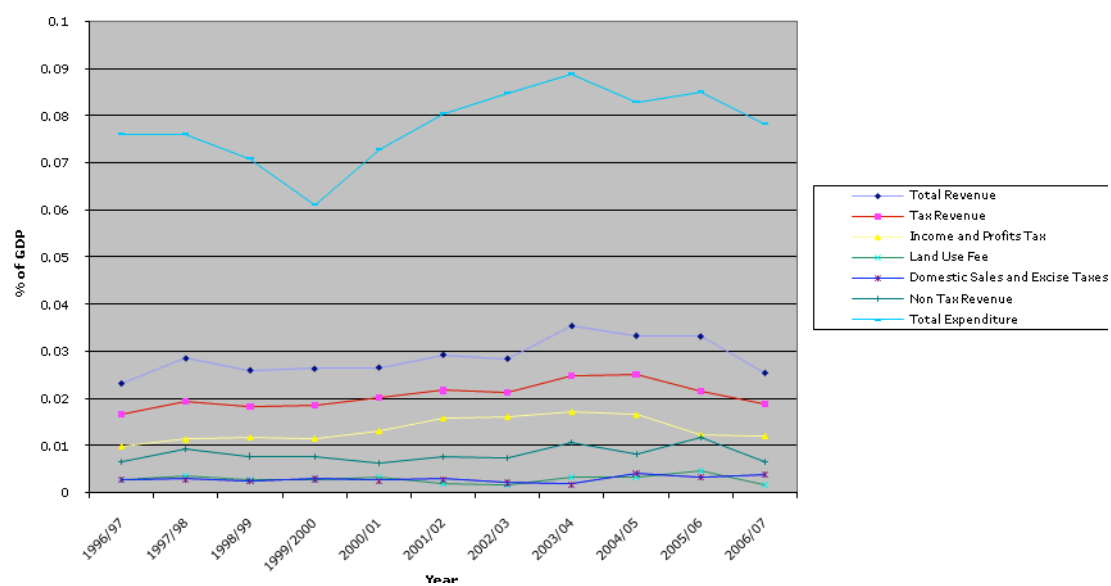


Source: Revenue data provided by the Ministry of Finance for 1975/76 to 2006/07. Data for subsequent years is drawn from the IMF Statistical Appendix, while earlier data is drawn from Wogene Yirko (1994). The government has adopted a new methodology for calculating GDP in recent years, and has updated earlier data using the new methodology such that a continuous data series exists from 1996/97. In order to construct a consistent data series for earlier years, GDP values prior to 1996/97 have been adjusted upwards by a factor of 1.27, which is the average adjustment for revised figures 1996/97-2004/05. The resultant trends for individual periods are unchanged, while the adjusted tax to GDP figures for earlier years are more credible and consistent after the adjustment.

Figure 8.A2: Expenditure and Revenue 1949-2008



Source: Expenditure data are drawn from IMF Statistical Appendixes from 1992/93 onward. Data from 1974/75 to 1991/92 is drawn from the IMF GFS. Earlier data is drawn from Wogene Yirko (1994). Revenue and GDP data is drawn from the same sources as in Figure 1.

Figure 8.A3: Composition of Regional Tax Revenue 1996-2007

Source: Ministry of Finance.

9. Does Tax Reliance Increase Responsiveness and Accountability?

This research has covered significant ground. While the research hypothesis is succinct, the research itself has been both broad and exploratory. The evidence that has been presented has been equally diverse. Each chapter has sought to tell part of the larger story, and each individual tax episode has had its own lessons and messages. The remainder of this thesis takes stock of the entirety of the evidence presented so far, and synthesizes it into a set of coherent and manageable conclusions. The analysis is divided into three brief chapters.

This chapter answers the primary research question: Is there compelling evidence that tax reliance has been a catalyst for increased responsiveness and accountability in Ghana, Kenya and Ethiopia? The analysis further focuses on the specific causal processes that have observably linked tax reliance to broader governance gains. Following this analysis, chapter 10 addresses the most important contextual factors that have shaped the relationship between tax reliance and the expansion of responsiveness and accountability. Finally, chapter 11 turns to the question of foreign aid and whether it may reduce levels of tax reliance and thus erode incentives for the expansion of responsiveness and accountability.

This chapter is organized in two parts. The first provides a broad summary of the evidence, while the second presents detailed analysis of the specific causal processes that have linked tax reliance to the expansion of responsiveness and accountability.

9.1. Reviewing the Evidence

The first question posed by this research has been whether there is compelling evidence that tax reliance has been a catalyst for the expansion of responsiveness and accountability in sub-Saharan Africa. While the research question is conceptually straightforward it is not easily amenable to empirical testing owing to the complexity of the causal processes of interest and the difficulty of directly observing those processes in practice. This thesis consequently began with a cross-country econometric analysis of the relationship between

taxation and accountability in sub-Saharan Africa. Finding the economic evidence to be inconclusive, it then moved on to a more detailed exploration of the relationship between taxation, responsiveness and accountability in three countries: Ghana, Kenya and Ethiopia. What follows provides a broad recapitulation of the evidence. The first part reviews the econometric evidence, the second re-introduces the key elements of the theoretical model underpinning the case study analysis and the third addresses the overall pattern of the case study evidence.

9.1.1. Econometric Tests and the Complexity of Causality

The empirical investigation began by revisiting earlier econometric studies that had reported a positive and statistically significant cross-country relationship between tax reliance and accountability. The econometric analysis presented in chapter 4 replicated the basic structure of existing cross-country studies, but improved upon them econometrically and, most importantly, by relying on a dramatically improved dataset. This analysis yielded two important results. First, it confirmed that available data is *consistent* with the existence of a positive relationship between tax reliance and accountability. All else being held equal, higher levels of tax reliance, measured as either total tax collection as a share of GDP or tax collection as a share of total government revenue, are consistently *correlated* with higher levels of accountability. Second, the analysis made clear that, contrary to earlier results, accepted econometric techniques do not yield compelling evidence of a robust *causal* relationship between tax reliance and accountability. Over a wide array of econometric tests there was simply no consistent pattern of statistically significant results.

While the analysis did not reveal a statistically significant causal relationship, this does not imply rejection of the hypothesis that tax reliance can be an important catalyst for the expansion of responsiveness and accountability in practice. Instead, the weakness of the results can be persuasively explained by the limitations of available data and, more importantly, the inability of the simple causal model underlying the econometric tests to capture the complexity of the causal relationship in practice. Specifically, the causal model that lies behind existing cross-country econometric evidence assumes that tax bargaining will follow a consistent temporal logic in which increases in taxation precipitate subsequent

improvements in accountability one, three or five years in the future. However, the case study evidence presented here makes clear that the causal processes that function in practice follow multiple different patterns, and consequently cannot be adequately captured by existing econometric models. While there undoubtedly remains scope for econometric approaches to further contribute to research in this area, the weakness of these econometric results provided a strong justification for pursuing a series of case studies capable of capturing the nature of relevant causal processes in more detail.

9.1.2. Theoretical Framework and Causal Model

In order to strengthen the case study analysis it was essential to begin by laying out a clear theoretical framework and causal model capturing the relationship between tax reliance and the expansion of responsiveness and accountability. Towards this end, Chapter 2 presented a model in which tax reliance is expected to contribute to broader governance gains by increasing the bargaining power of taxpayers relative to governments.

The first level of the model laid out two general channels through which the need for taxation may expand the political power wielded by taxpayers. First, tax reliance may expand opportunities for taxpayers to engage in *tax resistance*, and thus create incentives for governments to make concessions to taxpayers in order to improve tax compliance and increase tax revenue. Second, increased taxation may encourage *public engagement and collective action* among taxpayers seeking to ensure that they benefit from their tax payments. Within this simple framework, tax bargaining, leading to the expansion of responsiveness and accountability, is more likely when taxpayers are able to engage in tax resistance and collective action.

The second level of the model turned from these relatively general observations to identifying a subset of three clearly defined, and empirically observable, causal processes through which the need for taxation may contribute to the expansion of responsiveness and accountability. While these causal processes were not expected to capture some of the relatively implicit and unobservable ways in which tax reliance may shape levels of

responsiveness and accountability they provided a clear empirical basis for evaluating the case study evidence.

The first causal process was termed *direct tax bargaining*, and referred to cases in which governments respond to taxpayer demands by making relatively explicit concessions aimed at securing increased tax collection and curtailing public opposition. The second and third causal processes were jointly termed *indirect tax bargaining*, as they referred to cases in which governments do not make reciprocal concessions to taxpayers, but in which the need for taxation nonetheless contributes to long-term political change. Thus, *tax resistance and changes in government*, referred to cases in which resistance to taxation weakens the fiscal base of an incumbent government, creates pressure for a change in government and provides positive incentives for an incoming government to make concessions to taxpayers in order to improve tax collection in the future. Meanwhile, *strengthened political capabilities of taxpayers*, captures cases in which tax reliance contributes to strengthening civil society and the opening up of new spaces for political engagement, with long-term implications for the expansion of responsiveness and accountability. These latter two processes were an extension of standard models of tax bargaining, and reflected a desire to capture difficult to observe processes that are less explicit than direct tax bargaining but rely on a comparable causal logic and contribute to the outcomes of interest.

9.1.3. Evidence of Tax Bargaining

With this causal model as background, the case study chapters have presented historical narratives of the political economy of taxation, with a focus on the political dynamics surrounding particular tax episodes. The analysis of political processes surrounding these tax episodes has, in turn, provided the basis upon which to evaluate the presence, or absence, of a relationship between tax reliance and the expansion of responsiveness and accountability.

The primary challenge in evaluating the evidence is that the relationship between taxation, responsiveness and accountability is expected to be probabilistic, and as such we do not expect to observe evidence of direct or indirect tax bargaining during every tax episode.

Taxation remains a fundamentally coercive process and there will inevitably be instances in which taxpayers are unable to mount an effective response or in which governments increase tax collection irrespective of the protests of taxpayers. Thus, the expectation is not that every tax increase will result in tax bargaining, but that the case studies will collectively yield sufficient evidence of direct and indirect tax bargaining to confirm that tax reliance has been an important factor in the expansion of responsiveness and accountability.

Table 9.1 provides a general summary of the most important tax episodes from the four case study chapters (inclusive of Imperial Ethiopia). Particular tax episodes and outcomes are categorized as being representative of one of the three causal processes identified by the model or as falling into a fourth category, *taxation without tax bargaining*, which captures instances in which significant increases in taxation did not yield evidence of tax bargaining. Consistent with expectations, the case studies have yielded many examples in which increased taxation has not given rise to direct or indirect tax bargaining. This includes the relative absence of a response to the introduction of the VAT in both Kenya and Ethiopia, the lack of controversy surrounding large increases in tax collection in Kenya in the early 1990s and the limited public response to a variety of tax changes in Ethiopia since 1991. These episodes are a clear reminder that the presence of taxation is by no means a guarantee that governments will bargain with taxpayers or make any important concessions to them (Fjeldstad and Therkildsen 2008).

Despite these cases, the overall body of evidence makes clear that tax reliance can be an important catalyst for the expansion of responsiveness and accountability. It is possible to point to clear examples of each of the three hypothesized causal processes in each of the three case study countries. Moreover, these examples are substantively important, with tax bargaining contributing centrally to the expansion of public services, to changes in the way that taxes are administered and to processes of political liberalization. While there have been clear differences in the form and extent of tax bargaining across countries, the fact that there has been visible evidence of tax bargaining even in Ethiopia, where social, political and

Table 9.1: Summary of Key Episodes of Tax Bargaining

Taxation Without Tax Bargaining	Direct Tax Bargaining	Tax Resistance and Changes in Government	Strengthened Political Capabilities of
<p><i>Ghana:</i></p> <ul style="list-style-type: none"> • Tax Reforms 1982-1990 • Tax increases and fuel price increases 2001-2003 <p><i>Kenya:</i></p> <ul style="list-style-type: none"> • Introduction of VAT 1991-1996 • Major increase in tax collection 1993-1996 • Major increase in tax collection 1963-1972 • Fuel price increases 1994-96 <p><i>Ethiopia:</i></p> <ul style="list-style-type: none"> • Tax increases under the Derg 1974-1989 • Increased tax collection 1991-1998 • Increased collection of national taxes 2001-2005 • Increased tax collection 2007-2008 	<p><u><i>Improved Provision of Public Services</i></u></p> <p>Ghana: VAT increase earmarked for GET Fund 2000 Ghana: VAT increase (NHIL) earmarked for NHIS 2003 Ghana: Communications Tax earmarked for Youth Employment Scheme 2008 Kenya: Road Maintenance Levy 1994 Kenya: Business associations' demands for resolution of post-election violence</p> <p><u><i>Changes in Tax Policy and Administration</i></u></p> <p>All countries: Increased transparency in administration and taxpayer education Ethiopia: Tax Assessment Committees for presumptive taxation 2001 Ghana: Associational taxation for informal sector Ghana and Kenya: Increased taxation of SMEs to gain the support of the business community Ethiopia: Tax receipts given for land tax payments 1936</p> <p><u><i>Broad Expansions of Accountability</i></u></p> <p>Ghana: Anti-VAT protests and political liberalization 1995 Ghana: Resistance to fuel price increases and increased inclusiveness in decision making 1993 Ethiopia: Expanded public consultation around presumptive tax 2005 Ethiopia: Regional influence over senior government appointments in Gojjam 1967 Ethiopia: Strengthening of the Chamber of Deputies 1967</p>	<p><i>Kenya 1998-2002:</i></p> <ul style="list-style-type: none"> • Sharp decline in tax revenue resulting from reduced economic growth as well as aggressive evasion by government opponents • Change of government in 2002 elections aided by fiscal crisis • Major increase in responsiveness and accountability following elections, accompanied by steep increase in tax collection <p><i>Ghana 1998-2000:</i></p> <ul style="list-style-type: none"> • Declining tax revenue and growing deficit owing to tax resistance and resistance to increased fuel prices • Change of government in 2000 election contributes to political liberalization • Dramatically improved tax collection after elections <p><i>Ethiopia 1989-91:</i></p> <ul style="list-style-type: none"> • Fiscal crisis exacerbated by rural tax resistance and smuggling • Fiscal crisis central to overthrow of Derg government • Rapid fiscal recovery after transition 	<p><i>Ghana:</i></p> <ul style="list-style-type: none"> • Association of Ghana Industries (1999-) • Ghana Union of Traders Association (1989, 2007-) • Committee for Joint Action (1995-) <p><i>Kenya:</i></p> <ul style="list-style-type: none"> • Kenya Manufacturers Associations and Kenya Private Sector Associations (2002-) • United Business Association (2001, 2005-) • Nairobi Informal Sector Confederation (2002-) • Karen and Langata District Associations (1995-) • Kenya Alliance of Residents' Associations (1999-) • National Taxpayers' Association (2007-)

economic conditions would seem to mitigate against it, is particularly striking. There is no question that the evidence here comfortably meets the threshold of significance outlined in chapter 2: standard accounts of political development and change in the case study countries have been meaningfully enhanced by the inclusion of tax bargaining as an explanatory process. With this in mind, the next section delves more deeply in the evidence, and presents key examples of each of the three causal processes.

9.2. Causal Processes and Outcomes

This research has aimed not only to ascertain whether tax reliance has contributed to the expansion of responsiveness and accountability in the case study countries, but also to understand the specific causal processes through which this relationship has operated. This is not only of theoretical interest, but also has potentially important policy implications. Chapter 2 proposed three specific causal processes that appeared likely to link tax reliance to expanded responsiveness and accountability: (a) direct tax bargaining, (b) tax resistance and changes in government and (c) strengthened political capabilities of taxpayers. The case study evidence has confirmed that these three processes, while they disguise important diversity, have all been empirically important in linking tax reliance to the expansion of responsiveness and accountability. What follows summarizes the most important evidence of each process in turn, while this section concludes with a discussion of the relationship between particular types of processes and specific outcomes. While the importance of context is apparent in the discussion to follow, systematic discussion of particularly important contextual factors is reserved for chapter 10.

9.2.1. Direct Tax Bargaining

The term *direct tax bargaining* refers to cases in which governments have relatively explicitly conceded increased responsiveness and accountability in an effort to increase acceptance of taxation by citizens. The framework laid out in chapter 2 proposed that direct tax bargaining is likely to result in three observable types of outcomes, which are a subset of the broader concepts of responsiveness and accountability. These outcomes are: (a) broad expansions of accountability, (b) improved provision of public services and (c) changes in tax policy and administration. The case studies provided significant evidence

of direct tax bargaining, summarized in Table 9.1, and what follows briefly reviews three prominent examples, capturing each type of outcome in turn.

The most dramatic example of direct tax bargaining was the broad expansion of accountability that followed the anti-VAT protests in Ghana. In 1995 the Ghanaian government introduced a new Value Added Tax, and this effort prompted arguably the largest public protests of the previous fifteen years, and quickly led the government to repeal the new law, which was not reintroduced until 1998. More important than the repeal of the tax was the fact that the protests came to incorporate much broader demands for political liberalization, which, once catalyzed, persisted beyond the repeal of the tax itself. This put pressure on the government, which remained highly hierarchical, to move towards a more inclusive governing style. The government recognized that such a shift would be required both to calm the immediate anger unleashed by the tax protests and in order to regain the political legitimacy necessary to raise revenue in the future. Thus, there is near universal agreement in Ghana that the VAT protests were integral to a significant expansion of domestic accountability.

A second example from Ghana highlights the important role of subsequent tax bargaining in prompting sustained, and institutionalized, improvements in public service provision. In 2000 and 2003 successive Ghanaian governments sought to introduce increases in the VAT rate. As with the original introduction of the VAT, these plans were met by public outcry, and, in response, the government agreed to commit all new tax revenues to specific, and popular, social programs. This resulted in the creation of the Ghana Education Trust Fund, to support higher education and educational infrastructure, and a new National Health Insurance Scheme. Moreover, both funds were accompanied by the creation of new Boards of Directors intended to achieve a measure of transparency in the management of the funds. Thus, the government conceded targeted public spending, and a degree of increased oversight and transparency, in exchange for public acceptance of taxation, thus presenting a particularly explicit example of tax bargaining.

Finally, the imposition of the presumptive tax on small businesses in Ethiopia prompted the government to increase the transparency of the tax system and introduce new spaces for public engagement. Presumptive taxation had always held the potential for controversy owing to the subjective nature of tax assessment and the level of direct interaction between tax collectors and taxpayers. Thus, when the government sought improved enforcement of the tax beginning in 2001 it also pre-emptively decided to establish Tax Assessment Committees, composed of representatives from both government and the business community, to increase public confidence in assessment procedures. Despite this measure, the dramatic increase in enforcement led to significant controversy. While political repression in Ethiopia prevented this opposition from erupting into explicit protest, the government came to believe that unhappiness with the tax was an important reason for its lack of success in controversial elections in 2005. In response the government reduced rates and, more importantly, took further steps to expand transparency, most notably by creating new public forums in which citizens could raise questions and concerns about tax collection and public expenditure. Both the creation of these forums and the introduction of the Tax Assessment Committees were modest measures in absolute terms, but in a relatively closed political environment they were important, incremental, processes for institutionalizing consultation and participation, if not formal accountability.

9.2.2. Tax Resistance and Changes in Government

The case studies also capture important evidence of the importance of *tax resistance and changes in government* to the emergence of responsiveness and accountability. This causal process captures cases in which citizens have resisted taxation by an unpopular government, thus creating pressure for a change in government and positive incentives for future reform. These cases minimally require evidence that (a) tax resistance contributed to declining tax revenue, (b) fiscal crisis contributed to a change in government and (c) the new government ushered in important improvements in responsiveness and accountability. In addition to these factors, the most compelling cases were those in which incoming governments experienced dramatic revenue gains after explicitly linking governance improvements to efforts to increase tax collection.

The most clear-cut example comes from Kenya, where revenue collection declined dramatically after controversial elections in 1997. Much of the decline was attributable to declining economic growth, but well placed observers are near universal in arguing that it was also the result of explicit efforts by businesses aligned with the opposition to evade existing taxes, resist new taxes and weaken the fiscal position of the state. The success of this tax resistance contributed significantly to a growing fiscal crisis, which, in turn, made a change in government in the 2002 elections more likely. As importantly, having witnessed the struggles of its predecessor, the incoming government made tax reform a major priority and sought to explicitly link improved tax compliance to success in increasing political freedom and expanding popular social programs. Thus we have a clear case in which tax resistance, largely by elites, created added pressure for a change in government and provided positive incentives for future reform. It is also significant that when violence broke out after the 2007 elections the business community used the threat of non-compliance with taxation as an important means to gain leverage over the government in calling for a peaceful resolution.

A similar pattern was apparent in Ghana, where government controlled fuel prices were the central issue. As was noted previously, while government controlled fuel prices are not technically taxes, changes in fuel prices were fiscally and behaviourally equivalent to taxes, with higher prices for consumers entailing greater government revenue. In the late 1990s global fuel prices began to rise, which implied fiscal losses for the government if domestic fuel prices remained unchanged. The fiscally responsible choice would have been to raise domestic fuel prices along with global prices, but such an increase was judged to be politically impossible due to relentless public opposition driven by frustration with the declining pace of political liberalization. The inability of the government to raise fuel prices was, in turn, central to a growing fiscal crisis, and to this day remains a source of frustration to the government at the time. As in Kenya, the fiscal crisis contributed to a change of government in the 2000 elections. The incoming government learned from the fiscal struggles of its predecessor, and quickly made tax reform, including increased fuel prices, a major priority linked explicitly to broader political liberalization. Thus, again,

resistance to taxation created pressure for a change in government and generated positive incentives for the incoming government to adopt a reformist agenda.

In Ethiopia tax resistance has not played an equally decisive role, but there is nonetheless some evidence of the ability of taxpayers to use tax resistance as a means to respond to political repression. Under the Derg regime political opposition was aggressively controlled, while even the potential for tax resistance was reduced by government control over a significant portion of economic activity. Tax resistance in rural areas appears, nonetheless, to have played a meaningful, if still limited, role in accelerating the fiscal crisis that was central to the eventual overthrow of the government in 1991. While the incoming government remained autocratic, it undoubtedly marked a move towards political liberalization and greater responsiveness.

More than a decade later, the potential importance of tax resistance was again apparent, as tax collection fell sharply in the aftermath of highly controversial elections in 2005. In this case it was the government that pre-emptively decided to ease the aggressiveness of tax enforcement, but that choice was a response to quiet, but increasingly apparent, public opposition. The sharp fall in tax revenue after 2005 did not lead to a change in government, as the EPRDF was firmly entrenched in power and managed to aggressively repress the opposition. However, the fact that quiet public opposition was sufficient to generate a sharp fall in tax revenue collection even in a relatively repressive environment provides powerful confirmation of the ability of taxpayers to weaken unpopular regimes through their opposition to tax collection. While tax resistance did not generate major political changes in this particular instance, the case nonetheless reaffirms our confidence that tax reliance can increase the indirect political power wielded by taxpayers.

It is important to acknowledge that tax resistance, when it does not lead to more consensual direct tax bargaining with government, is a relatively blunt political instrument. While aggressive tax resistance can weaken an unpopular incumbent, it cannot guarantee that a new government will be more responsive and accountable than its predecessor. To take an obvious example, resistance to taxation by the landed nobility in late Imperial Ethiopia

contributed to a change in government, but the new government proved to be more repressive than its predecessor and aggressively attacked the same nobility that had resisted taxation under the Imperial regime. The basic message is nonetheless clear: when a government is reliant on tax revenue taxpayers have the potential to threaten the regime through tax resistance. In some cases that threat will contribute to direct tax bargaining, but even where it does not tax resistance can be a means to undermine repressive regimes, thus opening the door to reform.

9.2.3. Strengthened Political Capabilities of Taxpayers

The final causal process captures instances in which increases in taxation have acted as a catalyst for strengthening the political capabilities of taxpayers, thus contributing to long-term demands for responsiveness and accountability. While taxation may contribute to long-term levels of political engagement in relatively invisible ways, this research has focused on cases in which conflict over taxation has contributed to strengthening visible civil society networks and organizations, which have in turn made broader demands for the expansion of responsiveness and accountability.

The experience of the Committee for Joint Action (CJA) in Ghana speaks clearly to the centrality of taxation to the mobilizing efforts of civil society actors. The CJA was initially founded in the aftermath of the anti-VAT protests, emerging as an informal heir to the broader Alliance for Change, which directed the 1995 protests. While conflict over taxation figured centrally in the origins of the CJA, it subsequently grew beyond its initial founding, emerging as an important organizer of mass public mobilization around issues of political liberalization, corruption and poverty reduction. Yet even as the CJA has grown to encompass a much wider vision and focus, its efforts have continued to be profoundly shaped by tax debates. Since 1995 the CJA has repeatedly used frustration over tax related issues, including high fuel prices, as a central theme for mobilizing public protests aimed at demanding broader improvements in government performance. In the words of one of the CJA's leaders, "Taxes have always provided a focal point for public mobilization. Have provided momentum for the resistance."

More recently, the Centre for Governance and Development (CGD) in Kenya has made more explicit use of the idea that taxation can be a catalyst for public engagement over the longer-term. The CGD was already supporting local level expenditure monitoring when, in 2005, it decided to participate in the founding of a National Taxpayers' Association (NTA). The goal of the NTA was to explicitly link tax related concerns and advocacy to existing activities related to expenditure monitoring. The NTA organizers believed that by reinforcing community ownership of public revenues they could encourage more active public engagement. While still in its infancy, the campaign has found that the message that tax payment can be a basis for making claims on the government has significant public resonance, and has the potential to become an increasingly important basis for public engagement and advocacy.

Finally, the case studies have highlighted a wide array of examples in which taxes have played a role in catalyzing enhanced, and more constructive, political engagement amongst business associations. In some ways these examples are particularly interesting, as business associations are viewed by some as a key component of improved governance in the developing world, but have remained very weak throughout sub-Saharan Africa (Doner and Schneider 2000, Handley 2008). The central question about business associations in the region has long been whether they would act as narrow rent seeking organizations (Olson 1965, Goldsmith 2002), or whether they would become productive interest groups engaged in processes of "constructive contestation" with government (Handley 2008:2, Brautigam, Rakner and Taylor 2002). One of the key insights from earlier research is that, among other things, the emergence of constructively engaged business associations requires the emergence of a unified set of interests that encourages cooperation and collective action. Because taxation, when equitably applied, often represents a common threat to a large segment of business, it has played an important role in spurring precisely this kind of unified engagement with government. This has, in turn, had lasting implications for the ability of business associations to become active in demanding greater responsiveness and accountability from government. The impact of taxation on the activities of business associations can be seen among large business associations, including the Association of Ghana Industries and the Kenya Private Sector Association, as well as associations

representing small and medium enterprises, including the United Business Association in Kenya and the Ghana Union of Traders Association.

9.2.4. Linking Processes and Outcomes

The brief summary presented here provides evidence that tax reliance has been a catalyst for the expansion of responsiveness and accountability through three observable processes: direct tax bargaining, tax resistance and changes in government and strengthened political capabilities of taxpayers. The next question is whether particular processes have given rise to specific types of outcomes. Responsiveness and accountability, though closely related, are very different types of outcomes and may consequently be likely to result from particular processes.

While this is an intriguing possibility, there is no evidence that it is, in fact, the case. The examples of direct tax bargaining noted earlier have contributed to improved provision of public services, to changes in tax policy and administration and to broad expansions of accountability. Meanwhile, processes of indirect tax bargaining do not lend themselves to attributing specific outcomes to particularly episodes of tax conflict or tax resistance. Typically, tax resistance is one of many factors contributing to a change in government and to a wide array of political reforms. And where tax conflicts contribute to the strengthening of civil society, the need for taxation results in strengthened demands on government in the long-term rather than being the catalyst for a single specific outcome.

More generally, it seems likely that the nature of political outcomes will primarily reflect the political priorities of taxpayers and governments rather than the particular characteristics of any individual tax conflict. Levi (1999:115) has argued that the content of tax bargains will be shaped by the position and strategy of government. She writes that, “it is the ruler who extends the franchise and other rights in order to promote joint ventures with subjects whose cooperation the ruler requires to maximize his own revenue. In this view, only secure and relatively powerful rulers will act in this way; insecure rulers will grant exemptions to those whose alliance is necessary to protect power”. While the case studies do not cast light on her particular claim, which would require a much broader

comparative study, the general argument rings true. Faced with the same pressure from taxpayers, different governments will almost certainly make different types of concessions depending on their circumstances and priorities.

Turning to the role of taxpayers, their demands are likely to reflect both political circumstances and the characteristics of those most directly involved. The demands that emerged from the anti-VAT protests focused on political liberalization at least in part because the protests occurred at a time when the opposition was boycotting parliament and was thus particularly interested in political liberalization. Later bargains focused on the provision of public services in part because gains in political liberalization had already been achieved, thus shifting priorities. While bearing in mind the importance of context, it is possible that different taxpayer groups may have systematically different preferences, thus indirectly linking bargaining over certain types of taxes, affecting certain groups of taxpayers, to particular types of outcomes. Timmons (2005) has suggested that the lower-income majority may have a preference for public services, while higher-income taxpayers are more interested in institutionalized accountability, and this certainly sounds plausible. That said, there is a clear danger in making simplified assumptions about group interests, and the case study evidence here is not sufficiently broad to justify such expansive claims.

9.3. Conclusions

The introduction to this thesis set out three broad goals. First, to assess whether the need for taxation has contributed to the expansion of responsiveness and accountability in the three case study countries. Second, to capture the specific causal pathways through which this relationship has operated. Third, to better understand the most important contextual factors that have shaped the relationship between tax reliance and the expansion of responsiveness and accountability.

This chapter has addressed the first two goals. It has summarized a substantial body of case study evidence that has detailed the importance of tax reliance to the expansion of responsiveness and accountability in Ghana, Kenya and Ethiopia. This body of evidence captures three specific causal processes that underpin that relationship: direct tax

bargaining, tax resistance and changes in government and strengthened political capabilities of taxpayers. The discussion in this chapter has correspondingly summarized important evidence of each of these processes in practice. These three causal processes do not capture the entire range of ways in which tax reliance may contribute to the expansion of responsiveness and accountability, as some such processes are likely to be subtle and difficult to observe. For this reason the actual importance of tax reliance to the expansion of responsiveness and accountability is likely to be still greater than the sum of the examples presented here. Moreover, the findings reported here are focused exclusively on tax episodes related to central and regional government taxation, and thus do not address the equal potential for tax bargaining at the local government level, where the bulk of taxpayers in sub-Saharan Africa experience taxation most directly (Fjeldstad and Semboja 2001, Fjeldstad and Therkildsen 2008, Prichard 2010).

While the econometric tests presented early on in this thesis provided an ambiguous picture of the relationship between tax reliance and accountability, the subsequent analysis has made clear that those ambiguous results are likely a reflection of the complexity of the causal processes at work, which cannot be adequately captured by the simple causal model assumed by cross-country econometric tests. This thesis thus provides important empirical evidence of the importance of taxation to the emergence of responsive and accountable government. What remains is to explore the role of contextual factors in shaping the potential for tax bargaining. The evidence presented so far suggests that such contextual factors may be decisive, as the particular patterns of tax bargaining have varied enormously between Ghana, Kenya and Ethiopia. The following chapter thus seeks to capture the factors driving these differences in greater detail.

10. Contextual Factors and Tax Bargaining

While this thesis has presented evidence that tax reliance has contributed to the expansion of responsiveness and accountability in the case study countries, specific outcomes both within and across countries have been extremely varied. The Ghanaian case study captured extensive evidence of direct tax bargaining, while indirect tax bargaining figured more prominently in the Kenyan study. In Ethiopia observable evidence of tax bargaining was comparatively rare, owing to a range of social, economic and political factors. While each case study chapter presented partial explanations for observed patterns of direct and indirect tax bargaining, this chapter provides a more systematic accounting of the most important contextual factors shaping the relationship between tax reliance and the expansion of responsiveness and accountability.

In pursuing this task this chapter draws on a combination of the case study evidence and propositions derived from the existing literature. On their own, four case study chapters offer a limited basis for drawing definitive conclusions about the role of specific contextual factors, but when such evidence complements existing research propositions, significantly stronger conclusions are possible. This chapter does not seek to provide an exhaustive list of the contextual factors that may shape political outcomes, but instead focuses on six factors that are expected to be particularly significant. The choice of factors reflects received propositions from earlier studies, while special attention has been paid to factors that have emerged in the case studies presented here (Moore 2008, Levi 1988, 1999).

In order to understand the importance of context for the potential for tax bargaining it is useful to begin by again returning to the underlying causal model. It proposes that states that are more reliant on taxation are more likely to be responsive and accountable to their citizens because tax reliance increases the bargaining power of taxpayers and thus increases incentives for governments to make corresponding concessions. Tax reliance contributes to the relative bargaining power of taxpayers by increasing opportunities for tax resistance and enhancing the likelihood of public engagement and collective action. The contextual

factors that shape the potential for tax bargaining are correspondingly those that are likely to affect opportunities for tax resistance and the potential for collective action.

With this framing in mind what follows addresses six important contextual factors: (a) access to non-tax resources, (b) political institutions and context, (c) the strength and mobility of the private sector, (d) unity of interests among taxpayers, (e) taxpayers' awareness of taxation and (f) a set of additional factors conducive to collective action.

10.1. Access to Non-Tax Revenue

The first contextual factor of interest is implicit in the research hypothesis itself, and that is the importance of access to non-tax revenue. The evidence in this thesis has specifically addressed the extent to which the need for taxation has contributed to incentives for responsiveness and accountability in the case study countries. Yet, in a broader sense, this thesis feeds into debates about the difference between those countries that have access to significant non-tax revenue and those that are forced to rely primarily on tax revenue.

The evidence presented here, coupled with existing theory and empirical accounts, suggests that access to non-tax revenue may reduce the scope for tax bargaining through four broad channels. First, and most obviously, access to non-tax revenue generally leads to reduced levels of tax collection, thus reducing opportunities for tax resistance as well as the likelihood that taxation will spur political engagement and collective action. This issue warrants little further discussion at this stage, as the previous chapter has presented substantial evidence of the positive relationship between taxation and the expansion of responsiveness and accountability in the case study countries.

Second, states with access to non-tax revenue are likely, on average, to face greater revenue pressure, and thus to have stronger incentives to make concessions to taxpayers in order to secure greater tax revenue. Intuitively, when citizens engage in tax resistance, governments are likely to make reciprocal concessions if they face an urgent need for revenue, whereas states with large alternative sources of revenue may be more willing to tolerate reduced tax collection rather than conceding greater responsiveness and accountability. By the same token, tax resistance is more likely to contribute to a change in government, and to the

potential for subsequent reform, when the incumbent government has limited access to alternative sources of revenue. While the case studies presented here have not focused explicitly on these dynamics, they minimally provide evidence that tax resistance has been most successful in precipitating political change during periods in which governments have faced broader fiscal pressure, as at the end of the 1990s in both Ghana and Kenya.

Third, Ross (2004:234) has argued that when governments have access to extensive non-tax revenue the apparent “price” of public services for citizens, in the form of tax payments, is likely to decrease, as taxpayers receive greater services while paying less taxes than would be the case in the absence of non-tax revenue. He predicts that this is likely to reduce the tendency for taxation to spur taxpayers’ displeasure and consequent incentives to engage in collective action or tax resistance. While this thesis has not explored this possibility in detail, due to the difficulty of observing this possibility using the chosen methodology, it is an important issue to be explored in future research.

Fourth, access to non-tax revenue may reduce the likelihood of tax bargaining by making it possible for well-resourced governments to reduce public opposition through a combination of targeted patronage and enhanced repression. While this research has, again, not focused specifically on this possibility, it has minimally highlighted the extent to which well entrenched and highly repressive governments have been successful in preventing most forms of direct or indirect tax bargaining, at least for a time.

Finally, it is useful to conclude with a note about foreign aid. As has been periodically noted throughout this thesis, aid is likely in some cases to have similar effects to other sources of non-tax revenue in reducing the potential for tax bargaining. That said, the econometric evidence presented earlier also makes clear that while non-tax revenue from resource rents consistently leads to reduced levels of tax collection, the average impact of foreign aid on tax collection is more ambiguous. Meanwhile, it is relatively clear that foreign aid is not simply equivalent to other forms of non-tax revenue, owing to the existence of technical assistance and conditionality (Collier 2006). As such, the impact of

foreign aid on the potential for tax bargaining is the subject of a more detailed discussion in chapter 11.

10.2. Political Context and Institutions

Moving to contextual factors that lie outside of the core causal model, the case studies have made clear that the broad political context plays a central role in both the potential for tax bargaining and the extent to which direct or indirect bargaining is likely to be important. While the impact of political context and institutions is broad the discussion here focuses on three issues: the extent of political openness, the role of representative institutions in facilitating tax bargaining and the impact of elections and representative institutions on the level of revenue pressure facing governments. The section concludes by revisiting the causal model laid out in chapter 2 and proposes that while tax bargaining contributes to the expansion of accountability, the expansion of accountability can equally increase the potential for tax bargaining.

10.2.1. Political Openness, Repression and Tax Bargaining

The most basic message from the case studies has been that where governments are relatively repressive, tax bargaining, at least in relatively observable forms, is likely to be comparatively rare. This is intuitively unsurprising, as tax bargaining relies on the ability of taxpayers to engage in tax resistance and collective action, and both are likely to be more difficult in repressive environments due to the risk of retaliation by the state. Of the two, collective action is likely to be most difficult, and as a result the existence of political repression is not only likely to shape the extent of tax bargaining, but also its particular form. Specifically, we expect that in repressive environments direct tax bargaining, which is reliant on collective action by taxpayers, will be rare, while direct and indirect tax bargaining that emerge from tax resistance will be more important.

The case studies provide only a limited sample, but they are consistent with these predictions. First, tax bargaining has been rare in comparatively repressive contexts. This is most apparent in Ethiopia, where public engagement with tax issues was virtually non-existent under the Derg and where visible public action around tax issues has remained essentially unheard of under the EPRDF since 1991. In Ghana, tax bargaining likewise

remained essentially impossible under military rule from 1981-1992, despite dramatic increases in tax collection. In Kenya, those involved with taxation likewise attribute the absence of tax bargaining in the 1980s and 1990s to the relatively repressive character of the government, while visible public conflict over taxation has expanded since 2002.

Second, there is evidence that tax resistance has been a more important source of political leverage for taxpayers in repressive contexts, while collective action and direct tax bargaining have been more important where there has been greater political freedom. Ethiopia again provides the most striking example of a total absence of collective action in response to taxation. The Ethiopian case does present one significant example of direct tax bargaining, resulting from the presumptive tax on small businesses, but taxpayers never engaged in collective protests, rather expressing their grievances quietly through tax resistance, voting and informal channels. In Kenya in the late 1990s, taxpayers similarly did not engage in collective action in response to taxation, owing at least in part to restrictions on political freedom, but instead contributed to change by engaging in aggressive tax resistance that exacerbated the fiscal crisis in the lead up to the 2002 election. In contrast to these cases, Ghana since 1992 has experienced comparatively extensive political freedoms, and collective action in response to taxation has been correspondingly common. This has contributed to repeated examples of direct tax bargaining, beginning with the role of the anti-VAT protests in 1995 in advancing political liberalization.

10.2.2. Representative Institutions and Tax Bargaining

While the preceding discussion has focused on the broad impact of political context in shaping opportunities for tax bargaining, existing work has also focused more narrowly on the importance of representative institutions. The works of Levi (1988) and North and Weingast (1989) have argued that representative institutions are likely to increase the potential for direct tax bargaining by reducing the transaction costs involved in the process of bargaining itself. In fact, they argue that this was historically an important reason for the strengthening of such institutions. They argue that representative institutions provide a forum for aggregating taxpayer interests and demands, thus facilitating the relatively explicit exchange of expanded responsiveness and accountability for acceptance of

increased taxes. By contrast, in the absence of representative institutions, tax bargaining is likely to be relatively implicit, emerging from either aggressive tax resistance or relatively public conflict, such as tax protests.

These basic predictions are borne out by experience in Ghana. When the government sought to introduce the VAT in 1995 it did so at a time when the opposition was boycotting parliament, thus rendering organized political bargaining unlikely. The result was that the implementation of the VAT was undertaken hastily and was met by massive public protests led, to a large degree, by the political opposition. The resultant tax bargain did not emerge from any explicit agreement between protesters and the government, but from what Moore (2008) has termed “mutual behaviour adjustment”, as the government opted to adopt a more inclusive governing style in order to prevent similar protests in the future.

Part of the government reaction to the anti-VAT protests was a greater commitment to ensuring that the elections held in 1996 were perceived to be fair, which contributed to entry of the opposition into parliament. This, in turn, facilitated more explicit forms of direct tax bargaining. The reintroduction of the VAT was achieved peacefully in 1999 after significant consultation and bargaining between the government and the opposition resulted in a reduction in the initial rate. Later increases in the VAT rate likewise prompted public opposition, but that opposition was resolved through explicit bargaining in parliament that resulted in additional revenue being earmarked for the Ghana Education Trust Fund and the National Health Insurance Scheme, respectively. The same pattern was followed by other taxes, as the extension of the National Reconstruction Levy included explicit concessions to the business community, while part of the revenue from the Communications Tax in 2008 was earmarked for youth employment. The basic message is that once the role of parliament was strengthened so too was the potential for relatively explicit forms of direct tax bargaining.

10.2.3. Representative Institutions and Revenue Pressure

A final issue is the extent to which representative institutions increase demands for public services, and consequently the extent of the revenue pressure facing governments. In the historical cases captured by Tilly (1990), tax bargaining resulted when governments faced

severe revenue pressure brought on by the threat of war, and thus had strong incentives to bargain with taxpayers. By contrast, war has very rarely been a cause of similar revenue pressure in sub-Saharan Africa owing to the relative absence of significant inter-state warfare (Herbst 2000).²⁹

In the absence of revenue pressure generated by the threat of war, direct tax bargaining in contemporary sub-Saharan Africa has instead frequently resulted from the revenue pressure generated by elections and representative democracy. The case studies present significant evidence that elections have frequently strengthened popular demands for public services, thus creating pressure on governments to increase tax revenue collection.³⁰ Most notably, the Ghanaian government expanded public spending in response to the introduction of elections in 1992, which led to a significant fiscal crisis. This, in turn, set the stage for increased fuel prices in 1993, and for the introduction of the VAT in 1995, both of which resulted in the further expansion of accountability. Thus, by increasing the revenue pressure facing governments, democratization acted as a catalyst for tax bargaining and the further strengthening of accountability and democracy.

10.2.4. A Mutually Reinforcing Relationship

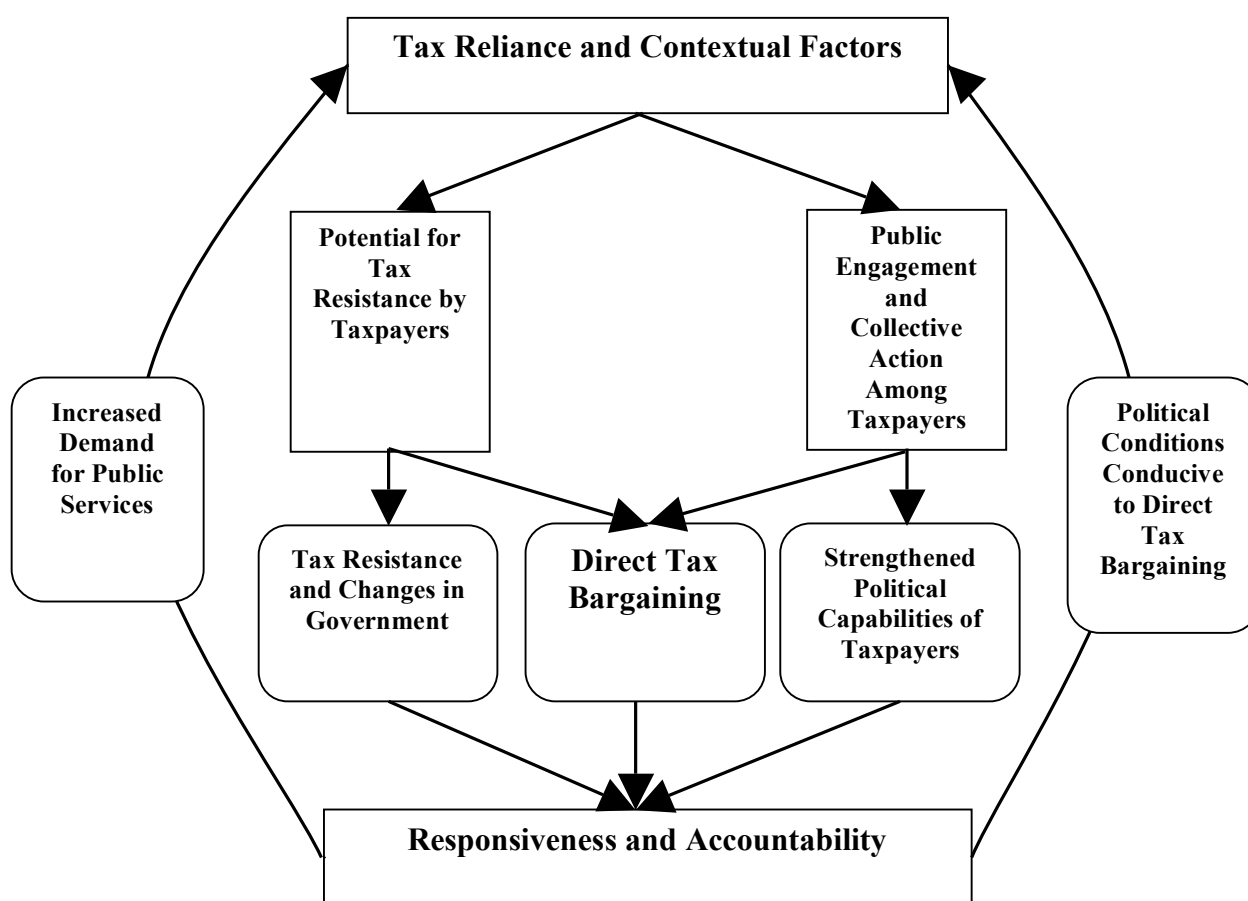
The basic message from the preceding discussion is that while tax bargaining is important to promoting expanded accountability, the reverse is also true: expanded accountability, reflected in reduced political repression and the existence of representative institutions, can also significantly contribute to the potential for tax bargaining. This plays out in two ways. First, reduced political repression and the existence of effective representative institutions can facilitate tax bargaining, and particularly relatively explicit forms of direct tax bargaining. Second, elections and the existence of representative institutions can increase demand for public services, and the consequent need for tax revenue. This is likely to increase the revenue pressure facing governments, thus expanding government incentives to

²⁹ This study has, of course, captured one of the rare exceptions in the case of the short-lived Ethiopian-Eritrean war in 1998-99.

³⁰ Econometric studies have yielded ambiguous results about whether, on average, democratization leads to higher levels of tax collection (Cheibub 1998, Mahon 2004, Boix 2001), but this ambiguity reflects the fact that democracy is likely to simultaneously increase demands for public services and create disincentives for governments to collect taxes, given the political cost. As such, these results do not at all contradict the general proposition that democracy is likely to frequently increase the revenue pressure facing governments.

make concessions to taxpayers in order to secure greater tax revenue. Together these two observations indicate that the relationship between tax reliance, tax bargaining and the expansion of accountability is not a one way causal relationship, but can in fact be a mutually reinforcing cycle, in which tax bargaining contributes to accountability, which, in turn, contributes to additional tax bargaining. This logic is captured in Figure 10.1, which extends the causal model initially introduced in chapter 2.

Figure 10.1: A Mutually Reinforcing Relationship Between Tax Bargaining and Accountability



10.3. The Strength and Mobility of the Private Sector

In Tilly's (1990) account of taxation and state building in early modern Europe the economic power wielded by the capitalist class was the decisive factor in shaping processes

of tax bargaining. Where the capitalist class was powerful tax bargaining was likely, while countries that lacked a strong capitalist class tended to pursue coercive taxation. The reason for this pattern was simple: capitalists controlled valuable and mobile economic resources and the state could only secure access to those resources through bargaining. It was comparatively easy for capitalists to evade or resist taxation, owing to the extent, secrecy and mobility of their assets, and states were thus compelled to make concessions to those taxpayers in order to encourage greater tax compliance. This logic is reflected in the classic model of tax bargaining developed by Bates and Lien (1985), in which the owners of mobile capital are most able to make demands on the state due to the potential for tax evasion and resistance. This logic also underpins the prediction that income taxes will be central to processes of tax bargaining, as income taxes are particularly important to the taxation of significant wealth and also pose the greatest threat of evasion (Mahon 2005, Lieberman 2002, Moore 1998).

In concrete terms, these models predict that a significant proportion of observed tax bargaining will be driven by the ability of owners of mobile capital to threaten, or actively engage in, tax evasion and resistance. More generally, they predict that tax bargaining will be most pronounced in countries with strong private sectors, and comparatively weak in poor and agrarian contexts (Moore 2008:40-42). These predictions are broadly borne out by the case study evidence. The ability of wealthy individuals and businesses to engage in aggressive tax evasion was central to episodes of direct and indirect tax bargaining in Kenya. The tax resistance that contributed to a change in government in 2002, and provided incentives for the incumbent to adopt reformist measures, was driven to a large degree by income tax evasion by large taxpayers. Later, when businesses were lobbying the government to resolve the violence that followed the 2007 elections, it was again the ability of large, mobile, businesses to threaten evasion that was important to those lobbying efforts. At a more general level, the relative absence of tax bargaining in Ethiopia is consistent with the fact that it is among the poorest, most agrarian, countries in the world, and much more weakly reliant on income taxes than either Ghana or Kenya.

Finally, in addition to the importance of a strong private sector to facilitating tax resistance through evasion, a strong private sector is likely to contribute to the emergence of tax bargaining by virtue of the fact that its control of significant economic resources can reduce vulnerability and thus create political space for public debate. In Ethiopia the weakness of public engagement with tax issues begins with the Chamber of Commerce, which has played a strictly educational rather than advocacy role. The weakness of the Chamber is, in turn, a reflection of the weakness of the private sector, and its dependence on the government. Prior to 1991 almost all large-scale economic activity was under the control of the government, and while government control and intervention have diminished over time, they remain significant. By contrast, the relatively more developed private sectors in Ghana and Kenya have given rise to business associations that have been significantly more engaged in generating public debate of tax issues, thus contributing to the potential for tax bargaining.

10.4. Unity of Interests

The analysis has so far has focused on broad features of the economic and political environment that are important to shaping the potential for tax bargaining. The remainder of this chapter focuses on factors that are more idiosyncratic, but which are essential to the ability of taxpayers to engage in effective collective action in order to make demands on government.

The first such issue is the importance of relatively unified interests and political objectives among taxpayers, as such unity underpins the political effectiveness of collective action. Without seeking to definitively explain the factors that account for taxpayer unity, the importance of taxpayers being able to rally around shared demands is readily apparent in comparing anti-VAT protests in Ghana and Kenya. In Ghana, the political opposition had been divided and ineffective during the 1992 elections, but the anti-VAT protests, under the umbrella of the Alliance for Change, successfully brought together leading opposition politicians, prominent members of civil society, large and small businesses and citizens at large, all unified around calls for the repeal of the tax and for political liberalization. It was this sudden show of unity by the opposition that was particularly shocking to the

government and explains the urgency with which it sought to expand the inclusiveness of future political decision-making.

By contrast, experience in Kenya demonstrates clearly that governments are unlikely to make collective concessions to taxpayers when such unity does not exist. When the government introduced legislation requiring the use of Electronic Tax Registers (ETRs), designed to reduce tax evasion, mid-sized businesses organized substantial nationwide protests. Yet, far from catalyzing broader demands for responsiveness and accountability, the protesters found themselves without support from the public or elites, both of whom labelled the protesters ‘Asian tax evaders’ rather than allies. Given this lack of public support, the government was able to press through the ETR requirement without making meaningful concessions to the protesting businesses. This general pattern is consistent with the fact that successive Kenyan governments since independence were able to introduce new taxes with a minimum of opposition by framing them as taxes on minority Whites and Asians. Had those being taxed been able to call on greater public sympathy there would likely have been significantly greater pressure on government to make concessions.

A specific issue related to the question of taxpayer unity is whether taxpayers will choose to respond to taxation by seeking narrow privileges and benefits for themselves or by pursuing broader governance gains cooperatively with other taxpayers. This question derives from Levi’s (1988:64) prediction that governments seeking to secure tax compliance will frequently prefer to grant narrow privileges (“side-payments”) to small groups of taxpayers rather than making broader concessions. There are thus important reasons to expect the pursuit of narrow privileges to undermine taxpayer unity, while tax bargaining is only likely to contribute to the expansion of responsiveness and accountability when sufficiently large groups of taxpayers opt instead to pursue broader benefits.

The importance of this issue is again revealed by Kenyan experience, where the ability of the businesses community to function as an effective interest group, engaged in broad tax bargaining, has been historically undermined by the pursuit of narrow benefits. Until at least the late 1990s the private sector was characterized by extensive patronage and rent

seeking, as many businesses responded to taxation by seeking individual benefits rather than broader political influence for the sector. As a result the major business associations played little role in engaging with tax issues or pressing for improved governance despite the relatively well-developed private sector in the country. As opportunities for such narrow rent seeking have diminished over the past decade the advocacy role of business associations has correspondingly expanded, including their involvement in pressing for the resolution of post-election violence in 2007-08.

The question of whether businesses and wealthy individuals are likely to respond to taxation by seeking narrow benefits or broad-based gains is particularly significant because elite involvement is likely to be very important to successful tax bargaining. This reflects the ability of elites to shape public opinion and to unify disparate grievances into a more effective set of political demands (Moehler 2006, McAdam, Tarrow and Tilly 2001:142-143). Seen in this light, the tendency towards narrow rent seeking among elites in Kenya, and even among MPs who have frequently blocked taxation targeting elite groups, helps to explain the broader absence of tax bargaining in the country, as collective action has been less likely absent the catalyzing role played by elites. Writing of the anti-VAT protests in Ghana, Ninsin (2007:94) stresses the elite dimension, arguing that, “those sporadic mass actions were part of opposition politics...They were therefore not driven by citizens' free will to effect policy changes.” While this may be an overly pessimistic assessment of citizen action, it nonetheless captures the centrality of elites both to making the VAT such a commanding political issue and to catalyzing public grievances into an identifiable political movement. The positive engagement of elites with tax issues, in turn, seems to reflect, at least in part, the extent to which the NDC government had insisted on enforcing taxation among elites more aggressively than previous governments (Nugent 1995).

10.5. Awareness and Political Salience

The role of elites as catalysts for public engagement with tax issues forms part of the broader argument that tax bargaining is more likely when taxpayers are more keenly aware of the taxes that they pay. This argument is intuitive, but nonetheless significant, and warrants careful attention.

In the field of public finance, discussion of this issue has generally revolved around what Martin and Gabay (2007:2) term “the visibility hypothesis,” which predicts that some taxes will be more visible to taxpayers, and thus more likely to provoke a political response. Specifically, income taxes, and other taxes paid directly by individual taxpayers to tax collectors, are expected to be more visible, and thus more politicized. By contrast, goods and services taxes, which are collected at the point of sale and then remitted to the government by individual businesses, are expected to be less visible to individual taxpayers, and thus less likely to provoke a response. This prediction is intuitively appealing, and on the surface would appear to be particularly relevant to developing countries, where the VAT is often hidden by the fact that small retailers, on whom most consumers rely, do not collect the VAT directly, despite paying VAT on their purchases of inputs (Bird and Gendron 2007).

Despite the widespread popular belief that income taxes will thus be more politicized than goods and services taxes, the case study evidence is relatively mixed. There certainly is significant evidence of the politicization of taxes that are directly paid to the government. Tax resistance in Kenya has consistently revolved around income taxes, while efforts by various residents’ associations to explicitly demand reciprocity for tax payments have focused primarily on direct property taxes. More compelling, the lone example of direct tax bargaining in Ethiopia since 1974 revolved around the highly visible presumptive tax on small businesses, while during the Imperial period tax conflicts consistently focused on direct property and agricultural taxes even though the largest increases in state revenue were coming from sales taxes and trade taxes.

However, while direct taxes have been politicized, so too have supposedly invisible taxes on goods and services. In Ghana far and away the most contentious taxes have been the VAT and fuel taxes, until recently embodied in government controlled fuel prices. The original introduction of the VAT led to the largest tax protests observed in any of the case study countries, while subsequent increases in the VAT rate required the earmarking of revenue for popular public services in order to minimize political opposition. Meanwhile changes in fuel prices, which remained functionally equivalent to tax changes as long as

prices remained government controlled, led to public resistance almost without fail. Finally, there were also large tax protests centring on the VAT in Kenya, in response to the requirement that medium sized firms use ETRs.

The message is that while awareness certainly does matter, the simple dichotomy between income taxes and goods and services taxes is an insufficient means to capture levels of awareness. This conclusion is echoed by Martin and Gabay (2007), who were the first to systematically test this question in developed countries. As a result, tax analysis needs to be concerned not simply with the crude concept of visibility, but with the slightly broader concepts of awareness and political salience, the latter following from Martin and Gabay's (2007:2) argument that protest often reflects "the ease with which [the tax] burden can be traced to the actions of policy makers." The concept of visibility may still play a role, as the almost complete absence of a public response to the initial implementation of the VAT in both Kenya or Ethiopia suggests that goods and services taxes are, indeed, often hidden from public view. Yet the case study evidence suggests that awareness and political salience are also shaped by other factors, including the reform strategy adopted by government and the role of elites in encouraging public awareness and engagement.

The importance of the reform process itself is particularly in evidence in Kenya, where the government has consistently adopted a gradualist approach to reform, with reform leaders transparent about their efforts to pursue reform "by stealth" in order to reduce public scrutiny. Unlike the decisive implementation of the VAT in most developing countries, the Kenyan VAT was implemented over the course of six years, with incremental changes over time used as a strategy to avoid public debate and controversy. By contrast, the most important episodes of tax bargaining in Ghana and Ethiopia occurred when reform was undertaken hastily and very publicly. This was true of the original introduction of the VAT in Ghana, and of the introduction of the presumptive tax on small businesses in Ethiopia, which produced major controversy in Amhara region, where it was introduced relatively suddenly, but less controversy elsewhere, where it was phased in gradually.

Returning to the role of elites in politicizing taxes that may not otherwise be visible to taxpayers, it is often the case that taxpayers in general are not fully aware of the burden of the VAT in their purchases, but business owners and political elites are. As such, the extent to which goods and services taxes spark awareness among taxpayers, and become politically salient, is likely to be a reflection of the success of business owners and elites in placing those taxes on the public agenda. The fact that the VAT prompted major protests in Ghana, and has remained a prominent and controversial issue since, reflects the fact that both political elites and organized civil society have been actively involved in transforming the otherwise relatively invisible VAT into an issue of national concern. The 1995 anti-VAT protests were largely attributable to a public belief, fed by elites, civil society and the media, that the new tax was going to cause major price increases. In subsequent years resistance to increases in the VAT rate again originated with the political opposition and organized civil society, both of whom mediated public understanding. Thus, the evidence suggests that when certain taxes do not prompt a broad-based public response an important part of the explanation is likely to lie in the actions of business owners, politicians, civil society and the media, all of whom play an important role in shaping the political salience of individual taxes.

10.6. Trust, Expectations and History

Many of the factors discussed so far are relevant because they are expected to contribute to the potential for collective action and, consequently, to the emergence of tax bargaining. These factors include the political context, the involvement and support of elites, the importance of unified interests among taxpayers and the broad centrality of awareness. Although not a comprehensive list of factors affecting the potential for collective action, these factors capture the most important issues that emerge from the case studies and from existing research about tax bargaining. Before concluding it is useful to touch briefly on two final issues that are likewise likely to be important to the emergence of tax bargaining, but around which it is possible to make only relatively general comments owing to the breadth of the topics and the limits of the case study evidence. These two factors are the importance of trust to tax bargaining and the role of history and expectations in shaping public responses to taxation.

10.6.1. The Importance of Trust

The importance of trust lies in the fact that in order for there to be direct tax bargaining, as opposed to tax resistance alone, citizens must trust that promises made by government will be implemented and sustained, while government must believe that increased tax compliance will similarly endure (North and Weingast 1989). If governments do not believe that concessions will, in fact, lead to increased tax compliance, they will have significantly weaker incentives to make such concessions (Gehlbach 2008). If citizens have sufficiently low trust in the government they will not be willing to comply with taxes beyond what can be compelled through coercion. This is the conclusion drawn by Fjeldstad and Semboja (2001) in writing about taxation in rural Tanzania, where citizens do, in principle, embrace the idea of a fiscal bargain, but are, in practice, unwilling to voluntarily comply with taxes because of extremely low levels of trust in government. Within the case studies presented here the importance of trust is best illustrated by the tax disputes that have occurred between the government of Ethiopia and pastoralist communities. The lack of trust has led the government to demand tax payments before providing better services, while pastoralists have long demanded better services, and treatment in general, before complying with taxes. The result has been perpetual conflict, despite the fact that tax bargaining appears to hold the potential for significant mutual benefit as well as an entry point for broader engagement between the two groups. The basic question is whether there are specific strategies that can be employed to progressively increase trust in such environments, and thus promote the potential for tax bargaining. While the emergence of strong political institutions offers the surest way to increase trust, the research and policy challenge is likely to lie in identifying intermediate strategies for achieving this same goal, but this is ultimately a much broader topic than can be captured here (Bird 2008, North and Weingast 1989, Braithwaite and Levi 1998).

10.6.2. Expectations and History

A final consideration in thinking about the factors that shape tax bargaining is the importance of expectations. The case studies have highlighted the intuitive notion that taxpayers are more likely to resist taxation, and demand reciprocal concessions from government, when they consider tax demands to be excessive and inconsistent with established notions of fairness (Tilly 1990: 101). This has, in turn, been shaped by history.

Evidence across the three countries suggests that where high levels of taxation have been well established historically there has tended to be less subsequent resistance to tax changes. In both Kenya and Ethiopia there is a clear sense among many observers that the lack of highly visible opposition to taxation reflects the fact that most taxpayers have come to expect existing levels of tax collection. In Kenya this reflects the success enjoyed by the immediate post-independence government in introducing a comparatively effective tax system, while in Ethiopia it reflects the history of extremely coercive taxation under the Derg government and the earlier Imperial regime. Indeed, there is anecdotal evidence that the relative absence of tax resistance in rural areas in Ethiopia may to some extent reflect the absence of expectations of reciprocity after a long history of coercive taxation. By contrast, in Ghana, where the acute economic crisis of the 1970s and 1980s decimated tax collection, the government needed to rebuild tax collection from extremely low levels and was periodically forced to bargain with taxpayers in order to do so.

In a broad sense, periods of change have proved decisive to the emergence of highly visible forms of tax bargaining. This suggests that taxpayers have tended to adapt their expectations to existing levels of taxation, consistent with evidence that levels of tax collection tend to be very stable over time within individual countries (Lieberman 2022, Bird 2008). It is possible, and even likely, that persistently high levels of taxation may increase levels of public engagement and oversight in less observable ways, but this remains an important question for future research to address more fully. What the case study evidence here makes clear is that episodes of highly visible and direct tax bargaining have tended to surround periods of significant changes in taxation, thus making history an essential determinant of the prospects for tax bargaining later on.

10.7. Conclusions

This chapter has addressed the primary factors that have shaped the emergence of particular types of tax bargaining in the case study countries. This is an ambitious agenda, and this chapter makes no claim to having captured every dimension of this question. Instead, the factors presented have addressed the most important propositions emerging from existing literature, while providing an explanation for the patterns of tax bargaining observed in

each of the three case study countries in this thesis. The overarching message from this discussion is that contextual factors figure centrally in whether, and how, tax reliance contributes to the expansion of responsiveness and accountability.

Before concluding this discussion of contextual factors, it is useful to step back and draw on the insights provided here to consider the potential for tax bargaining in poor, politically repressive, contexts. These are the contexts in which tax bargaining is potentially most valuable, yet both existing research and the case study evidence here suggest that they are also the contexts in which tax bargaining is least likely. In broad terms, political repression makes collective action and tax protests more difficult, while the weakness and immobility of economic producers reduces the scope for tax evasion as well as the broader political resources wielded by citizens. However, the message from this research is that while the potential for tax bargaining in such contexts is limited in absolute terms, tax bargaining can offer a rare source of political leverage to taxpayers in contexts in which few such opportunities exist.

While tax bargaining was rare in Ethiopia, it was not non-existent, and revolved around the fact that even in the face of repression taxpayers found ways to resist taxation. This weakened the fiscal position of repressive governments and, at least in the case of the presumptive tax, compelled the government to make concessions. Aside from the particular benefits of these examples of relatively visible tax bargaining, these episodes support the suspicion that in repressive environments the tax reliance of governments may also contribute to pressures for greater responsiveness and accountability in relatively less observable ways. The Ethiopian government clearly understood that tax compliance was shaped by popular perceptions, implying that, at the margin, it faced consistent additional incentives to improve performance. Likewise, the government decision to reduce tax collection in the wake of the 2005 elections suggests a belief that taxation was quietly contributing to politicizing the citizenry. This suggests that even in poor, repressive, contexts, governments that are reliant on taxation are likely to face stronger incentives to improve performance in order to secure tax compliance and are more likely to be confronted by a politicized citizenry. Unfortunately, observing such subtle processes in

politically controlled environments is difficult, and conclusions consequently tentative and demanding of further research.

11. Foreign Aid and Tax Bargaining

This thesis has argued that the need for taxation can strengthen pressures for the expansion of responsiveness and accountability, while access to significant non-tax revenue has a corresponding potential to undermine the likelihood of tax bargaining. In recent years the latter possibility has received increasing attention from policy makers concerned with the implications for foreign aid. This interest has centred on the possibility that by reducing the tax reliance of recipient governments, foreign aid may inadvertently reduce pressures for the emergence of greater responsiveness and accountability (Moore 1998, Moss, Pettersson and van de Walle 2006, Brautigam and Knack 2004).

Despite growing interest in this question among policy makers, existing research has remained highly speculative and open to challenge on empirical grounds. The view that foreign aid may reduce incentives for domestic responsiveness and accountability has, instead, been sustained largely by the *a priori* strength of the theoretical argument. What is needed is a systematic framework for thinking about the impact of foreign aid on the tax reliance of governments, and on the broader potential for tax bargaining.

The bulk of existing empirical research has focused on the straightforward question of whether access to foreign aid tends to reduce levels of tax collection in recipient countries (Moss, Pettersson and van de Walle 2006, Brautigam and Knack 2004, Knack 2009). While much of the earliest research concluded that aid does, indeed, lead to reduced tax collection, recent evidence, including that presented in chapter 5, has called these results into question. Beyond these concerns about the robustness of available econometric results, there has been a broader failure to thoroughly consider the multiple ways in which foreign aid is likely to shape domestic tax reliance and tax systems. This chapter thus begins by reviewing existing econometric evidence and then proceeds to address three additional, and largely overlooked, issues: first, the multiple factors that are likely to shape the impact of aid on levels of tax collection; second, the impact of aid on the *dependence* of governments on tax revenue, as a share of total revenue, and the likely implications for tax bargaining;

and third, the impact of aid on the character of tax systems, and the possible consequences for the likelihood of tax bargaining. The discussion here does not aim to provide a definitive statement about the impact of aid on the potential for tax bargaining, as foreign aid has not been the explicit focus of this research. Instead, what follows provides a framework for thinking more systematically about the relationship between foreign aid, taxation and the expansion of domestic responsiveness and accountability. Examples from the case studies offer important initial insights, while the broader goal is to provoke additional research in the future.

11.1. Foreign Aid and Domestic Tax Collection

Existing research linking aid to the potential for tax bargaining has frequently revolved around the narrow question of whether access to foreign aid leads to lower levels of domestic tax collection (Moss, Pettersson and van de Walle 2006, Brautigam and Knack 2004). Many early tax effort studies, canvassed in chapter 5, reported a negative and causal relationship between levels of foreign aid and levels of domestic tax collection (Remmer 2004, Gupta et al. 2005, Devarajan, Rajkumar and Swaroop 1999, Brautigam and Knack 2004, Knack 2009). More recently, Knack (2009) has reported evidence that high levels of aid dependence have led to weaker tax administration, as measured by World Bank country experts, owing to less investment in institution building. Of these studies work by Gupta et al. (2004) at the IMF produced the most dramatic, and widely cited, conclusions, finding not only that aid reduced domestic tax collection, but that it was grants in particular that led to reduced collection, while loans did not have a similarly negative effect.

Despite the fact that these findings are intuitively appealing, recent work using improved data and alternative econometric methods has demonstrated that the relationship between foreign aid and taxation is, in fact, much more ambiguous. The econometric results presented in Chapter 5 find, if anything, a modest positive relationship between aid and levels of domestic tax collection. This result is echoed in a more recent IMF paper (Gupta 2007), while work by Clist and Morrissey (2010) finds a moderately positive relationship over the past two decades, during which donors have given significantly greater attention to domestic revenue generation. The message from these more recent studies is that foreign

aid may very well contribute to lower levels of domestic tax collection in some cases but there is no consistently negative impact of foreign aid on levels of domestic tax collection across developing countries. This reflects the complexity of the relationship between foreign aid and domestic tax collection and argues for a more nuanced approach to understanding that relationship.

11.2. How Does Foreign Aid Affect Tax Collection?

An improved understanding of the relationship between aid and domestic tax collection must begin with an acknowledgement that the term ‘foreign aid’, while seemingly capturing a straightforward and homogeneous category, in fact disguises an extremely diverse underlying reality (Collier 2006). The term encompasses many very different types of financial transfers to developing nations, delivered for a wide variety of different reasons and in hugely variable contexts. In looking at the broader question of aid effectiveness, the then Chief Economist of the World Bank argued that, “The empirical literature on aid effectiveness has yielded unclear and ambiguous results. This is not surprising given the heterogeneity of aid motives, the limitations of the tools of analysis and the complex causality chain linking external aid to final outcomes” (Bourguignon and Sundberg 2007: 316).

While it is not possible to address the entire diversity of aid modalities and motives here, it is useful to consider two broad issues. First is the fact that foreign aid is more than a simple financial transfer that is functionally equivalent to revenue from natural resource rents (Collier 2006, Therkildsen 2002). Foreign aid frequently includes technical assistance for strengthening tax policy and administration and conditionality linked to government programs, levels of revenue collection and particular elements of tax reform. These additional factors inevitably shape tax outcomes. Second, the impact of aid on domestic tax collection is likely to be highly context specific, shaped both by domestic political conditions and by the priorities of donors. The sections below address each element in turn.

11.2.1. Revenue Incentives, Technical Assistance and Conditionality

The case study evidence, combined with earlier works, suggests that aid can affect domestic tax collection through three direct channels - pure revenue incentives, technical assistance and conditionality – as well as indirectly by generating increased expenditure pressure (Collier 2006).

The first channel is the impact of *pure revenue incentives*. Taken alone, the availability of aid revenue seems likely to reduce the priority and urgency accorded to domestic tax collection, as aid revenue can frequently act as a substitute for tax revenue in financing important government functions and services. While governments with access to substantial foreign aid revenue may not actively decide to reduce tax collection, when faced with the political costs associated with increased tax collection such governments are more likely to avoid political conflict, implicitly accepting reduced levels of collection.

The second channel is through the role of *technical assistance*. Donors have committed significant revenue to supporting tax policy reform and improved tax administration in individual countries, while also supporting the emergence of transnational communities of tax professionals that have been central to driving reform agendas across the globe (Fjeldstad and Moore 2008). While small relative to total aid flows, the OECD estimates that tax related assistance amounted to \$121 million worldwide in 2005 (OECD 2008). While debates continue about the design and implementation of these programs, there is little doubt that they have had a significant impact on both levels of tax revenue collection and the ways in which revenue is collected (Sanchez 2006, Bird 2008).

The third channel is through *revenue conditionality*, as donors have increasingly made domestic revenue collection an important formal and informal condition for the disbursement of foreign aid. This conditionality has typically taken two forms. The first is matching funds requirements, by which donors have required local governments to provide a share of project financing before the disbursement of aid revenues (Fjeldstad 2001). The second is broader conditionality in which aid funds, particularly in the form of budget

support, are made conditional on recipient governments raising a minimum level of total tax revenue or implementing particular tax reforms. Both forms of conditionality have played an important role in each of the case study countries. In a sense, donors have taken on the role of taxpayers, bargaining with government by virtue of the political power that they enjoy through their funding of government activities. They are able to compel recipient governments to act in particular ways because they wield the implicit or explicit threat that they will otherwise reduce aid flows, much as taxpayers wield the threat of tax evasion and resistance.

While there are longstanding debates about the effectiveness of conditionality and technical assistance in aid programs (Collier et al. 1997), existing research unambiguously finds that international actors have played an important role in shaping tax policy and administration in developing countries (Fjeldstad and Moore 2008, Sanchez 2006, Thirsk 1997). This broad message is supported by the case study evidence, which confirms that the availability of aid has sometimes reduced incentives for tax collection in recipient countries but also that donors have encouraged significant revenue collection gains.

The Ethiopian case offers the most striking evidence of the complexity of the relationship between tax collection and aid, with periods over the past two decades in which aid appears to have had both significantly positive and negative impacts on tax collection. During two recent periods foreign aid appears to have reduced the urgency with which the government pursued increased revenue collection. The first was during the period 1995-1998, when levels of tax collection stagnated at a relatively low level despite the pressing needs of post-conflict reconstruction. At the time aid levels were very high, and stable, and public officials are transparent about the fact that while revenue mobilization was considered important, it was never a leading government priority. The second was in the aftermath of the 2005 elections when the government decided to reduce some tax rates and reduce the intensity of tax enforcement. Given the fiscal pressures facing the government at the time it seems inconceivable that it could have allowed such a fall in revenue in the absence of significant aid flows.

Yet, while these examples point to the role of aid in reducing tax effort in Ethiopia, tax officials in Ethiopia were also adamant about the positive influence of donors on levels of tax collection. During interviews with senior officials, external pressure and support were almost universally cited as crucial factors in motivating the successful tax reforms initiated in 2001. In fact, it was suggested that with the government preoccupied with internal political conflicts, it was only external intervention that ensured the priority given to tax reform. Tax officials are similarly adamant that during the early 1990s, immediately following the end of the civil war, the government could not have reinvigorated tax collection as quickly as it did without external support.

Turning to the Ghanaian case, foreign aid seems to have had a largely positive impact on levels of domestic revenue mobilization. Technical assistance figured prominently in the tax reforms during the 1980s and 1990s, as the Ghanaian tax reform followed donor prescriptions very closely, and came to be viewed as a model for reform elsewhere on the continent. Conditionality likewise appears to have played a prominent role, most evidently in pushing the government to introduce the failed VAT in 1995. Tax administrators make clear that donor conditionality remained important in subsequent years as well, particularly with respect to the formation of the Revenue Agencies Governing Board to oversee the three distinct revenue agencies.

Meanwhile, Kenya exhibits the same contradictory patterns as Ethiopia, demonstrating both the negative incentives created by aid, but also the importance of technical assistance to revenue gains. The most telling episode surrounds the dramatic tax reforms that took place from 1993-1996. The reforms followed the partial suspension of aid in 1991, and there is a clear sense that the strained relationship with donors helped to encourage the government to increase domestic revenue collection. This suggests that the availability of aid suppressed tax effort during the 1980s. That said, the same episode points to the positive potential of aid, as technical assistance was integral to the revenue gains during the period, and continued to be important to subsequent episodes of tax reform (Glenday 1999).

Having thus highlighted the contradictory ways in which foreign aid may affect domestic tax collection, it is valuable to conclude by highlighting a fourth channel through which aid may indirectly encourage higher levels of domestic tax collection. While much more difficult to observe, this channel can be captured under the banner of *expenditure pressure*. Foreign aid is frequently accompanied by conditionality related to the expansion of pro-poor government spending, particularly with respect to social services including health and education. While in the short-term aid allows the government to provide these services without resorting to the collection of tax revenue, in the long-term the expansion of social spending may create pressures for the expansion of government revenue in order to sustain those programs when aid declines or shifts towards other priorities. Thus, rather than creating disincentives for tax collection, conditionality associated with aid may generate indirect pressure for greater social spending, and thus increased tax collection over the longer-term. While this claim is not easily testable, this possibility is widely acknowledged by policy makers within the case study countries. The fact that this possibility has not been more widely recognized in recent work on aid and taxation is surprising, as the possibility that aid may generate substantial long-term expenditure commitments for recipient governments was widely acknowledged in the 1980s, including in the hugely influential World Bank report *Accelerated Development in Sub-Saharan Africa* (World Bank 1981: 126-128).

11.2.2. The Importance of Context

While foreign aid thus shapes domestic taxation through multiple channels, the impact of aid is also likely to be highly context specific. While this is a much broader issue than can be adequately captured here, it is helpful to flag three general contextual factors that shape outcomes: donor motives and coordination, domestic priorities and perceptions of aid among recipients.

With respect to the objectives of donors, for conditionality to be effective donors must be coordinated in their demands on governments, and be willing to cut aid funds if conditions are not met. In practice, these requirements for conditionality to be effective are frequently not met, in part due to high levels of donor fragmentation, and the effectiveness of

conditionality has varied accordingly (van de Walle 2005, Frot and Santiso 2010). This has particularly been an issue in recipient countries that are considered geo-politically important, as donors have been unable to gain leverage in making demands on governments due to their unwillingness to cut aid flows in the case that conditions are not met.

Historically this primarily applied to countries that were strategically important in the context of the Cold War (Dunning 2004). This was true of Kenya, and helps to explain why the Kenyan government faced limited pressure for increased taxation in the 1980s, but felt much greater pressure to generate domestic revenue (as well as for economic and political reform more generally) after the end of the Cold War (Throup and Hornsby 1998). More recently countries that are strategically important in the so-called Global War on Terror appear to be having a similar experience, with donor countries reluctant to cut aid flows for fear of losing strategic allies (Moss, Roodman and Standley 2005)³¹. This appears to be true to at least some extent in Ethiopia, which helps to explain the ability of the government to allow a sharp fall in tax collection after 2005 despite donor protestations. These are, again, complicated questions, but the basic message is that the impact of aid on domestic incentives for tax collection is heavily dependent on donor coordination and motives.

Domestic political dynamics also shape the impact of aid. It is well accepted that conditionality and technical assistance are both highly dependent on the existence of a base of domestic support. Put another way, conditionality and technical assistance can make a particular outcome more likely, but domestic priorities are generally the determining factor in shaping actual outcomes. This basic observation has spawned widespread critiques of conditionality, and to a lesser extent of technical assistance, on the basis of significant evidence that external pressure is a highly imperfect substitute for domestic political will

³¹ Moss, Roodman and Standley (2005) find that the allocation of U.S. aid funds in sub-Saharan Africa does not appear to have been altered significantly by such strategic interests. However, the argument here is not that aid flows have necessarily increased in Ethiopia, but that donors are reluctant to reduce aid flows because of the strategic importance of Ethiopia given its proximity to Somalia. This contention is supported by those involved at the country level and by the relatively modest impact that well documented electoral fraud and subsequent repression around the 2005 elections has had on aid (Lyons 2006).

and public pressure for bringing about genuine and sustained reform (Collier et al. 1997, Moss, Pettersson and van de Walle 2006).

This reality is so well accepted that a single example from the case studies is sufficient. In Ghana during the 1990s donors sought to advance four tax related issues through a combination of technical assistance and conditionality: the introduction of the VAT, computerization of the Internal Revenue Service, creation of a single revenue agency and the liberalization of government controlled fuel prices. Yet, despite significant pressure from donors on all four fronts, actual outcomes reflected government priorities. The government pursued the VAT aggressively, despite public resistance, showed little enthusiasm for computerization and the creation of a single revenue agency, and actively resisted demands for the liberalization of fuel prices, despite being offered HIPC debt relief in return. In simplest terms, what actually occurred reflected what was politically feasible domestically, and in that sense it was the interaction between foreign aid and domestic politics that shaped tax outcomes.

The final question relating to context is whether, and to what extent, governments view aid as a genuine substitute for tax revenue. The contention that aid will reduce domestic tax effort rests on the implicit assumption that governments perceive the two as substitutes. Yet, if aid is being allocated to programs that are not government priorities, or if governments simply dislike external conditionality, they may prefer to replace aid revenue with tax revenue, despite the costs. This appears to have been a factor in Kenya, where the Kibaki government explicitly linked efforts to increase tax collection to the desire to reduce aid-dependence. While this stance was partially rhetorical, and designed to garner public support for tax collection, there is little doubt that the government's desire to reduce its reliance on aid was genuine, and grounded in a desire to avoid external conditionality.³²

³²³² In fact, during the violence that followed the 2007 election the government repeatedly, and very publicly, insisted that it would not bow to international pressure, as it was not financially dependent on aid revenue. Some observers informally go so far as to suggest that aid independence was consciously sought by the government at least in part to weaken the potential for external actors to constrain its political activities, including electoral fraud.

Much more could be said about the importance of international and domestic context in shaping the relationship between aid and domestic tax collection, but it is beyond the scope of this study. The goal here is simply to highlight the fact that the aid-taxation relationship is extremely complex, and that simple, linear, conclusions are inadequate.

11.3. Foreign Aid and Dependence on Taxation

The basic conclusion to be drawn from this analysis is that the relationship between aid and taxation is variable. There is a genuine risk that access to foreign aid may reduce incentives for domestic tax collection, and thus limit the potential for tax bargaining to catalyze the expansion of responsiveness and accountability. At the same time, there is no persuasive evidence that aid *consistently* leads to reduced tax collection. The reality in any individual country is much more complex, as aid frequently makes important *positive* contributions to levels of tax collection, both through targeted technical assistance and the conditionality associated with broader aid flows. Increased attention to the potential unintended political consequences of aid dependence is appropriate, but a blanket condemnation of aid is certainly not.

There remains a need to highlight two additional elements of the relationship between foreign aid, tax reliance and tax bargaining. The first is the impact foreign aid has on the dependence of governments on tax revenue, as a share of total revenue; second is the effect of how tax revenue is collected on the potential for tax bargaining.

Turning to the first, there has been a tendency in recent studies, and in discussion of these issues in policy circles, to equate tests of the impact of aid on levels of tax collection with the broader question of whether aid may reduce tax-related demands for the expansion of responsiveness and accountability (Moss, Pettersson and van de Walle 2006). However, the two questions are not equivalent. While there is now evidence that foreign aid does not consistently lead to lower *levels of tax collection*, it nonetheless, by definition, leads to reduced levels of *tax dependence*, as a share of total government revenue. This reduced tax dependence, even in the presence of constant levels of tax collection, may reduce the likelihood of tax bargaining.

As was noted in the previous chapter, there are two reasons for this. The first is that access to non-tax revenue is likely to result in government being less willing to make concessions to taxpayers, as it is likely to face lower levels of revenue pressure. The threat posed by tax resistance, through either evasion or collective action, is diminished, as any given loss of revenue to the government constitutes a smaller share of total revenue. The government is thus more able to forego the additional tax revenue, by simply relying on non-tax revenue sources, rather than making concessions to taxpayers.

Second, the presence of significant foreign aid may reduce the likelihood that taxpayers will engage in collective action to bargain with government. One reason is that when the government has access to significant foreign aid the apparent ‘price’ of public services, defined by the level of services relative to the taxes paid, is likely to decline, potentially reducing incentives for political mobilization (Ross 2004). In addition, governments that are heavily reliant on foreign aid may sometimes be responsive to donor demands rather than the demands of citizens. Coupled with the frequent lack of local level transparency about donor funding, this may contribute to a sense of disempowerment among citizen groups, with long-term consequences for levels of public engagement (Moss, Pettersson and van de Walle 2006, van de Walle 2005).

Taken together, these arguments provide a strong *a priori* case for believing that while foreign aid does not consistently lead to lower levels of tax collection, it may nonetheless reduce the potential for tax bargaining through its impact on levels of dependence on tax revenue. Unfortunately, while the logic of this argument is compelling, testing it is much more challenging, as it requires comparing actual outcomes to what the government and taxpayers would have done had dependence on taxation been higher or lower. This counterfactual is, of course, unobservable. The research challenge is thus to focus on episodes that can provide convincing, though still indirect, evidence of how tax dependence has shaped government and taxpayer behaviour. Unfortunately there is virtually no existing research on this specific question. What follows presents evidence of the likely impact of

aid, and its absence, on the potential for tax bargaining in Somaliland and in the case studies presented here, but conclusions are necessarily very preliminary.

Interesting evidence comes from Eubank's (2010) recent study of Somaliland, which is unique within the modern state system in that it has had a functioning and independent government since its founding in 1991 but has never received official development assistance to the national government.³³ This is due to the fact that Somaliland has never been recognized by the international community, which officially still considers it a part of Somalia. The absence of foreign aid makes Somaliland a sort of natural experiment for asking whether the absence of foreign aid does, in fact, make tax bargaining more likely.

Eubank (2010) argues that the absence of foreign aid has, indeed, made constructive tax bargaining more likely, with benefits for levels of public accountability. He focuses on the early years of the new government in 1992-93, at which point a dominant governing faction had emerged but lacked access to substantial tax revenue. The most obvious source of tax revenue was the taxation of trade, but the major port was controlled by a rival faction, and thus not accessible to the new government. This initially led to armed conflict, but this conflict eventually gave way to negotiation, out of which the government gained control of the port in exchange for extending a greater governing role to the rival faction. This compromise was foundational to the consolidation of democratic government in Somaliland, which has remained largely intact since. Eubank persuasively contends that if the new government had had access to foreign aid it would have been much less likely to enter into this tax bargain. While the revenue available from the port was indispensable to the government under the circumstances that prevailed, the amount of revenue would have paled in comparison to the levels of aid that are generally available to similarly low-income nations.

While these conclusions are necessarily speculative, and many factors contributed to the unique outcomes in Somaliland, the narrative provides evidence that access to foreign aid

³³ Somaliland does receive low levels of aid, sometimes unofficially, to local authorities and through civil society organizations, but this has few implications for the argument made here.

would likely have reduced the impetus for tax bargaining and compromise by reducing the revenue pressure facing government. The case studies presented here provide further support for this proposition, though, again, conclusions can only be speculative. What the case studies suggest is that, consistent with the causal model presented in chapter 2, tax resistance and collective action have been more likely to yield gains in responsiveness and accountability when governments have faced significant revenue pressure. The anti-VAT protests in Ghana, and the subsequent compromises made by the government, were motivated by a looming fiscal crisis and threats of aid reductions by donors. Had the government not faced the threat of reduced aid it is likely that it would not have introduced the VAT as quickly as it did, or at such a high rate, and that it consequently would not have been forced to make equally significant political concessions to taxpayers. Similarly, the tax resistance that contributed to changes in government in both Kenya and Ghana arose in part because those governments already faced significant revenue pressure owing to stagnant growth, escalating global fuel prices and, in Kenya's case, historically low levels of foreign aid. Again, greater access to aid could have reduced the revenue pressure facing government, and thus the role of tax resistance in creating incentives for a change of government and subsequent reform.

The evidence presented here is by no means sufficient to establish beyond doubt that foreign aid has reduced the potential for tax bargaining by reducing the revenue pressure facing governments. The preceding discussion is, instead, aimed at the more modest goal of highlighting an aspect of the relationship between aid, tax reliance and tax bargaining that has frequently been overlooked, while presenting preliminary evidence to suggest that this aspect of the relationship is empirically important.

11.4. A Governance Focused Tax Reform Agenda

The discussion so far has advanced existing research by highlighting the complexity of the relationship between aid and tax reliance. This has involved capturing the multiple channels through which foreign aid affects levels of tax collection and the importance of the impact of aid on the extent to which governments are dependent on tax revenue. From a policy perspective these findings make clear that donors should seek to mitigate the

potentially adverse consequences of aid for levels of tax reliance. Moreover, they argue that donors need to pay greater attention to the ways that aid is likely to shape domestic political dynamics through its inescapable impact on the dependence of recipient governments on tax revenue. This final section adds an additional element to understanding the impact of foreign aid on the potential for tax bargaining, highlighting the importance of the impact of aid not only on levels of tax reliance but also on *how* tax revenue is raised.

One of the central contributions of this research has been to highlight specific processes of tax bargaining in contemporary developing countries and, correspondingly, to identify specific contextual factors that have the potential to strengthen connections between taxation and the expansion of responsiveness and accountability. The case study evidence has made clear that these contextual factors have been essential to explaining particular outcomes. While the contextual factors laid out in the previous chapter include broad questions of political context and the structure of economies, they also include more specific considerations, including the importance of unified interests among taxpayers, of awareness and the political salience of taxes, and of trust between taxpayers and governments. These latter factors have many roots, but are likely to be shaped to an important degree by the nature of tax systems themselves, including the types of taxes that are collected, the character of tax administration and the way that governments pursue tax reform.

The message for policy makers, including donors, is that changes in how tax revenue is raised can make an important contribution to strengthening links between tax reliance and the expansion of responsiveness and accountability. At the same time, foreign aid donors need to guard against encouraging changes in tax policy and administration that may have negative implications for the potential for tax bargaining. The latter possibility has been raised by Fjeldstad (2001), who has argued that revenue conditionality in rural Tanzania has led to increased levels of tax collection, but has also encouraged the use of increasingly coercive methods of tax collection, reducing the potential for tax bargaining.

Donors have played a very important role in shaping both tax policy and administration across the developing world, as reflected in the remarkable similarity of many tax systems. While much could be said about the benefits and limitations of this “global tax reform agenda,” the issue here is that those setting this agenda have almost certainly *not* been focused on the potential role of tax reform in encouraging or discouraging tax bargaining and broader governance gains (Fjeldstad and Moore 2008: 255). The intention here is not to attempt to propose the specific elements of such a governance focused tax reform agenda, as existing evidence remains limited and proposals are thus necessarily speculative (Prichard 2010). However, the evidence in this thesis has made clear that the character of tax systems shapes the strength of links between tax reliance, responsiveness and accountability. It follows that such considerations should be a more central feature of future tax reform efforts. The discussion on contextual factors in chapter 10 provides very broad guidance as to the types of tax reforms that are likely to encourage tax bargaining. These include reforms that increase popular awareness and understanding of taxes, encourage public engagement in tax debates, build trust between taxpayers and governments and improve the transparency of tax systems. There are important opportunities for future research to explore these possibilities in greater detail.

11.5. Conclusions

This chapter has explored the relationship between foreign aid, taxation and domestic responsiveness and accountability, addressing the argument that foreign aid, by reducing the tax reliance of recipient governments, may contribute to weakening domestic pressure for responsiveness and accountability. The goal of this chapter has been to draw on the conclusions presented by this thesis to introduce a nuanced framework for systematically analyzing the relationship between aid, taxation and tax bargaining. While the case studies have provided distinct new insights into certain elements of this relationship, the framework outlined here has also raised important additional questions for both researchers and policy makers.

This chapter has argued that, contrary to many earlier findings, foreign aid does not consistently lead to lower levels of tax collection in recipient countries. Instead, the impact

of aid on domestic tax collection is likely to reflect the combined impact of revenue incentives, technical assistance and conditionality, as well as the importance of both domestic political context and donor priorities. The impact of aid on levels of tax collection is thus ambiguous. Equally important is the fact that aid can lower the dependence of recipient governments on taxation, thus running the risk of reducing the revenue pressure facing recipient governments and of diminishing incentives for taxpayers to engage in collective action, with negative implications for levels of responsiveness and accountability.

Finally, this chapter has argued that how taxes are collected is likely to have important implications for the likelihood of tax bargaining, and that governments and donors have an opportunity to focus on tax reform priorities that are likely to encourage domestic responsiveness and accountability. While the findings from the case studies provide some general guidelines as to the potential content of those reforms, this is a subject that warrants significant future research.

12. Conclusions: Key Messages and Opportunities for Further Research

This thesis began with a simple observation: there is extensive evidence that conflict and bargaining over taxation figured centrally in processes of state building in early modern Europe and the United States, but these same political processes have remained largely unexplored in sub-Saharan Africa. Against this background, a small group of scholars have persuasively argued that the study of taxation holds the potential to yield important new insights into the foundations of responsive and accountable government in the developing world.

Earlier scholars have thus paved the way for this study. However, their work has remained largely historical and theoretical, leaving a pressing need for empirically driven studies. While a number of isolated econometric studies have emerged in recent years, complemented by a group of case studies that have captured individual examples of tax bargaining, this study has been the first extended effort to systematically explore the relationship between tax reliance and the expansion of responsiveness and accountability in the developing world. This has dictated the adoption of an ambitious and exploratory research design, which has drawn on both econometric and case study evidence in order to capture the extent, and limits, of the relationship between taxation, responsiveness and accountability in Ghana, Kenya and Ethiopia.

12.1. The Research Contribution

The breadth of the research agenda has allowed this thesis to make a series of research contributions. At the broadest level, it has provided evidence that the need for taxation has, in fact, contributed to the expansion of responsiveness and accountability in Ghana, Kenya and Ethiopia, though with significant differences across the three cases. More specifically, this thesis has made five particular contributions.

First, it has drawn on a rich and complex historical and theoretical literature in order to present a novel causal model and framework for empirical research in this area. This causal model undoubtedly obscures a certain amount of complexity, as the three causal processes that have been the focus of the case study analysis do not capture all of the pathways that may link tax reliance to the expansion of responsiveness and accountability. However, despite these necessary compromises, the model presented here provides the first systematic basis for empirically exploring the relevance of taxation to changes in responsiveness and accountability at the country level, and has the potential to be an important starting point for future research.

Second, the thesis revisited existing cross-country empirical tests of the connection between tax reliance and the expansion of accountability, and provided new results and an improved understanding of the complexity of the relationship. While earlier studies had reported a positive and causal relationship, the results reported here relied on improved data and methods and found that there is, in fact, no significant evidence of the existence of such a positive relationship. More importantly, the econometric analysis concluded by arguing that the ambiguous results can be explained the fact that standard cross-country econometric tests cannot capture the complexity of the underlying causal processes. Thus the econometric analysis provided an important argument in favour of more detailed and nuanced case study and quantitative evidence.

Third, the bulk of the thesis has presented detailed case study evidence that has both confirmed the importance of taxation to the expansion of responsiveness and accountability in the case study countries and provided detailed new insights into the particular characteristics of processes of tax bargaining. By relying on extended historical narratives of the political economy of taxation in three very different contexts, the case studies have been able to capture detailed evidence of tax bargaining that has included both highly explicit cases of direct tax bargaining and longer-term, more easily overlooked, processes. These longer-term processes have captured the role of tax resistance in creating pressure for political reform as well as the importance of conflict over taxation to strengthening the political capabilities of taxpayers. These narratives provide the most detailed existing

accounts of the broader politics of taxation and state building in the contemporary developing world.

Fourth, by virtue of relying on extended historical accounts this is the first study to provide detailed evidence of the contextual factors that have shaped the potential for tax bargaining in individual countries. The case study narratives have offered empirical support for existing propositions from the historical and theoretical literature about the importance of political and economic contexts in shaping outcomes. They have also highlighted the importance of a series of more specific contextual factors, including shared interests among taxpayers, trust between taxpayers and governments, the involvement of elites, the characteristics of different tax types and the ways that tax reform and administration are carried out. These factors have not only expanded our understanding of tax bargaining, but have important policy implications.

Fifth, this thesis has provided new insights into the impact of foreign aid on domestic taxation, and the possible unintended consequences for domestic responsiveness and accountability. Chapter 11 described in detail the complexity of this relationship and proposed a detailed framework for addressing it more systematically. The case study evidence has also provided important initial lessons, demonstrating the need for increased attention to the impact of foreign aid on the potential for tax bargaining.

12.2. Policy Implications

While this study has largely avoided detailed discussion of policy issues in favour of maintaining a strict focus on the research question, the policy implications of the findings reported here are significant, particularly with respect to foreign aid. Aid donors have frequently had an important impact on the tax reliance of recipient governments and on the character of tax systems in developing countries, but the broader governance implications of this impact have often been overlooked. On a positive note, the past two decades have seen aid donors pay increasing attention to the need to ensure that aid does not lead to reduced levels of tax collection in recipient countries. While this has been primarily

motivated by fiscal, rather than governance, concerns, the evidence here suggests that these efforts are likely to have important governance benefits.

The impact of aid on domestic tax *collection* is therefore an important policy issue. But equally important are issues related to tax *reliance*. Even where levels of tax collection are sustained, foreign aid still inevitably reduces the dependence of recipient governments on tax revenue and consequently runs the risk of eroding domestic incentives for the expansion of responsiveness and accountability. This is not a condemnation of aid, but argues that donors need to be more aware of the impact that aid can have on political outcomes. In broad terms this means making efforts to ensure that in relieving the revenue pressure facing governments aid does not also undermine domestic demands for reform. It also means delivering aid in a way that is not likely to discourage public engagement in revenue and budgeting processes. Beyond these generalities more research is needed and holds the potential to yield significant benefits.

The final policy message relevant to both donors and national governments is that the way that tax is collected is likely to be important for fostering strong linkages between tax reliance and the expansion of responsiveness and accountability. Thus there is a need for future tax reform efforts to take into account the implications of different options for broader governance outcomes. This idea was captured in a recent presentation by the Commissioner General of the Uganda Revenue Authority, who argued to her colleagues that, “We should elevate ourselves from being just tax collectors and tax administrators to being state builders.”³⁴ This thesis has suggested that the types of measures that are needed are likely to be those that increase popular awareness and understanding of taxes, encourage public engagement in tax debates, build trust between taxpayers and governments and improve the transparency of tax systems. However, there is a need for much more research in order to develop more specific policy recommendations (Prichard 2010).

³⁴ Presentation to the inaugural conference of the African Tax Administration Forum, Kampala, Uganda, November 20, 2009.

12.3. Limitations and Future Research

The need for additional research extends well beyond these relatively specific policy questions. This thesis has made clear that conflicts and bargaining over taxation have played an important role in shaping political outcomes in the case study countries, but in doing so it has also raised a range of additional questions. At a general level, research in this field derives from a rich and detailed historical literature that has explored the diverse connections between taxation and state building across a large number of countries and over several centuries. While this research has provided a similar set of narratives from sub-Saharan Africa, the breadth and detail of these narratives remains comparatively modest. Similarly, the arguments in this thesis have drawn on an impressive historical and theoretical literature, but it is beyond the scope of any individual study to capture all of the complexity raised by those earlier works.

Of necessity, this thesis has focused on some questions to the exclusion of others, capturing relatively observable processes, at the central and regional government levels, in a particular group of countries, using a methodology that has focused on the political implications of changes in levels of taxation. Much remains to be done. This final section of the thesis is committed to highlighting five of the most important issues that have not been addressed, in order to point towards likely avenues for future research.

First, this thesis has focused on the role of tax bargaining in linking taxation to the expansion of responsiveness and accountability. It has correspondingly not focused on the importance of tax reliance to the strengthening of broader state capacity, which has been the focus of important research elsewhere (Brautigam 2008a, Brautigam and Knack 2004, Prichard and Leonard 2010). It similarly has not focused on the possibility that governments that are reliant on tax revenue may be more likely to adopt growth-promoting policies owing to their common interest in promoting the prosperity of taxpayers and subsequently increased tax receipts. Both issues are centrally important to broader scholarship dealing with the importance of taxation to state building in the developing world.

Second, and perhaps most importantly, this thesis has focused on a subset of relatively observable causal processes that have linked tax reliance to the expansion of responsiveness and accountability. This is likely to capture only some of the ways in which taxation is linked to broader changes in governance in practice, as there are good reasons to believe that some relevant processes may be difficult to observe (Moore 2008:38). For example, the need for tax revenue may quietly shape government behaviour, providing modest, but constant, incentives for responsiveness and accountability. These small, relatively invisible, changes in government behaviour over time may amount to significantly improved outcomes over the long-term. Another possibility is that tax reliance may have subtle, long-term, impacts on the political engagement of taxpayers as they come to feel increased ownership over government activities. These subtle processes, while unobservable by looking solely at visible tax conflicts, may nonetheless be a profoundly important way in which tax reliance creates long-term pressure for public responsiveness and accountability. The observable processes captured in this thesis provide a significant indication that these less observable are also *likely* to operate in practice. That said, there is a clear opportunity for future research that seeks to capture such processes more explicitly, perhaps beginning with continued efforts to study the impact of taxation on public perceptions and simple forms of political engagement (Fjeldstad and Semboja 2001).

Third, while tax bargaining is likely to depend on the overall tax reliance of governments, the case studies have focused more narrowly on changes in levels of tax collection. This has been a pragmatic choice motivated by the potential for observing the political implications of such changes. Observing the implications of changes in dependence on taxation, brought on by changes in access to non-tax revenue, is likely to be comparatively difficult, but there is nonetheless a need for such research. This is particularly true in the case of foreign aid, as the discussion in chapter 11 has highlighted the potentially important political implications of reduced dependence on tax revenue, even where levels of tax collection are unaffected.

Fourth, this research has focused on a particular set of countries, with certain characteristics in common, to the exclusion of others. While the causal processes identified in the case

studies seem likely to be generally relevant beyond the case study countries, there is nonetheless a strong case for exploring the specifics of tax bargaining in quite different contexts. Perhaps the most important opportunity lies in conducting similar research in countries that have access to significant non-tax revenue. Such research could address the question of whether changes in tax collection, even where levels of tax collection are comparatively low, have the potential to yield similarly important processes of tax bargaining. In resource dependent countries falling levels of non-tax revenue often force governments to increase taxation, and research has an opportunity to gain a deeper understanding of the likely political implications.³⁵ Equally of interest is the potential to study the role of tax bargaining in post-conflict settings. The need for many post-conflict states to rebuild tax collection from very low levels would seem to offer important opportunities to make revenue raising processes an entry point for broader governance gains, including strengthening engagement and trust between taxpayers and the state (Boyce and O'Donnell 2007).

Finally, this research has focused exclusively on taxation at the national and regional government levels, to the exclusion of local government taxation. This choice is justified by the heavy centralization of revenue collection in sub-Saharan Africa, but this does not minimize the potential importance of local government taxation to the expansion of responsiveness and accountability. While most revenue is collected at the national and regional levels, the majority of taxpayers in sub-Saharan Africa experience taxation most directly at the local government level, owing to an array of taxes, fees and levies involving comparative small sums. These taxes and fees result in high levels of taxpayer awareness and direct interaction between taxpayers and tax collectors, while the connection between revenue and public expenditure is likely to be more apparent at the local government level. As a consequence, local government taxation appears intuitively likely to encourage tax bargaining and public engagement. While a number of existing studies have noted that local government tax systems in sub-Saharan Africa are frequently highly coercive, thus restricting the scope for direct tax bargaining, there remains a strong possibility that tax

³⁵ This has, for example, recently been the case in Nigeria in the wake of declining oil prices, according to data from the Nigeria Federal Ministry of Finance.

reliance may nonetheless shape government behaviour and public engagement in more subtle ways (Fjeldstad and Semboja 2001, Fjeldstad and Therkildsen 2008, Hoffman and Gibson 2005).

12.4. Final Thoughts

This thesis has made important new contributions to our understanding of the foundations of responsive and accountable government in sub-Saharan Africa, but research in this field remains in its infancy and there are enormous opportunities for further work. Research of this kind has been extremely limited in sub-Saharan Africa, where scholarship has tended to focus on the role of particular political institutions and on the colonial origins of these institutions, and of development outcomes more generally. Research focused on the political dynamics surrounding revenue raising provides a valuable complement to this existing body of work, not only because of the specific insights that emerge but because such research turns our attention toward the broad forces that shape state-society relations and bargaining between citizens and their governments. As such, an important goal of this thesis is to contribute to sparking the continued expansion of research in this field.

List of Key Interviews

Ghana

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