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## Research Report

# Reforming tax systems in the developing world: What can we learn from the past?

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Report

# Reforming tax systems in the developing world

What can we learn from the past?

Roel Dom and Mark Miller

June 2018



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Cover photo: A money exchanger counts Somali shilling notes on the streets of the Somali capital Mogadishu. Credit: Stuart Price.

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# 1 Introduction

With the adoption of the Sustainable Development Goals (SDGs), taxation has once again taken up a central spot on the international development agenda. To fund these ambitious goals, the international community is not only calling on private capital to step in, but also on governments in developing countries to increase their domestic resource mobilisation, and in particular taxation (UN, 2015). The recent Addis Tax Initiative saw a commitment from participating providers of international support to collectively double their technical cooperation to domestic revenue mobilisation by 2020. While this increased commitment is welcome, it is not necessarily the case that money spent on technical cooperation will translate into improved tax systems.

International actors have been giving advice on how developing countries should levy taxes since before the second world war. However, tax ratios have been stubbornly stable, particularly in low-income countries (Bahl and Bird, 2008; Keen and Mansour, 2010). This stylised fact is illustrated in Figure 1. Caution is needed

in drawing conclusions,<sup>1</sup> but given the available data and fully acknowledging its limitations, we can draw out some trends. For advanced countries there was an upward trend in taxation between the 1960s and the 1990s, after which the tax ratio stabilised. For developing and emerging countries, however, the trend was increasing until the 1970s, after which it decreased and diverged away from advanced countries. Only recently did it start to pick up again, though the gap between the two is still large. Moreover, underlying these aggregate trends sits significant (regional) heterogeneity. Some regions like sub-Saharan Africa have yet to surpass their 1970s tax levels.

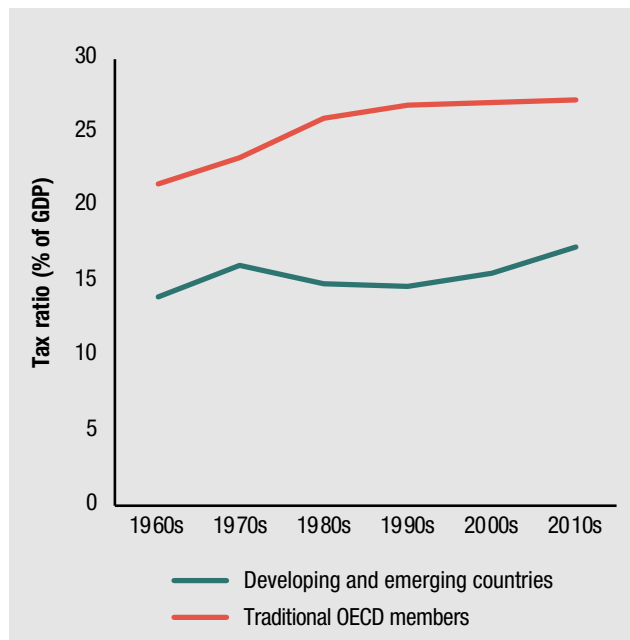
## 1.1 What this paper is (not) about

There are, then, questions to be asked about the wisdom of spending more aid on tax. Is it simply the case that the nature of current support and the way in which it is delivered is adequate, but that there is just not enough of it? If so, all that is needed is more of the same. Or, do we also need to rethink both the content and approach to international tax advice?

One way of supporting more critical deliberation over the nature of technical cooperation is to better understand how ideas have evolved as well as the lessons that have been learnt (and not learnt) from past efforts to strengthen tax systems. Indeed, the past century has witnessed profound shifts in perspectives on the role of taxation in development, moving from a legitimate tool of the state in the developmental process following the Second World War to a necessary evil that should be broad-based and neutral with respect to economic activities at the turn of the century. Changing perspectives on the role of taxation and the drivers of development more broadly have had significant ramifications on the nature of reform advice provided.

This paper adds to the discussion by providing an accessible summary of the key academic ideas and policy debates over the past century that have shaped the nature of technical cooperation on tax system reforms in developing countries. It then connects these debates with the direction of travel of international cooperation on taxation. This review is by no means exhaustive: rather it draws out the ideas and literatures that have proven to be particularly salient during different periods of time. This synthesis draws in particular on the work done by scholars such as, Goode (1993), Stewart (2003), Lledo,

**Figure 1 Evolution of tax ratio for advanced and developing countries**



Notes: Decade averages. Ratios in % of national income and exclusive of social security contributions.

Sources: Chelliah et al. (1975); Tait et al. (1979), Prichard et al. (2014) and OECD (2016)

<sup>1</sup> Figure 1 is illustrative only. It was put together with data from various sources: samples vary, and definitions might too. Care must be taken in drawing strong conclusions, especially for earlier decades.



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Schneider and Moore (2004), Bahl and Bird (2008), Bräutigam, Fjeldstad and Moore (2008) and Bird (2013).

This paper is best thought of as a broad sweep of the literature covering the historical developments in taxation and development. It is bound to be selective, and subjectively so. In compiling this work, we were guided by some of the broadest changes in thinking about taxation and about development. This means we forgo a wide array of important factors. We do not focus on specific people or institutions, though more emphasis is put on the tax advice provided by the Bretton Woods institutions as they have emerged as the most influential actors in this space from the 1980s onwards, at the expense of the UN and some of the regional actors. Nor do we zoom in on particular topics, which means we do not cover the important issue of resource taxation, for instance. Equally, given our global perspective, we miss out on some of the important regional and local dynamics. We do not paint an exact picture of all that happened, but rather aim to give a general introduction to some of the most far-reaching developments. Aware of this limitation, we have aimed to include a wide range of references to provide the reader a pathway into more in-depth reading on specific topics.

The paper is targeted at officials working in donor organisations or governments who have an interest in reforming tax systems, but who might not be familiar with the key academic debates that have underpinned the evolution of ideas. It might be of interest to people who want to take a step back from the nuts and bolts of specific reforms and ask what all these reforms are for.

## 1.2 Framework

The trigger for tax reform is often highly context-specific, originating in fiscal pressures or political changes. Reforms, therefore, often reflect the influence of contemporary as well as historical social, political and economic pressures in a country. However, increasingly tax reform occurs in a globalised world, and is influenced by international forces. This is particularly the case for developing countries, which often rely on international support for tax reform. Tax systems are thus influenced by a set of internationalised ideas about what the main concern of the tax system should be (Lledo et al., 2004).

Perspectives on the foundations of effective tax systems have changed over time and varied considerably across different schools of thought. However, we found that two evolutions have particularly influenced international thinking on tax system reform:

- Changing perspectives on the drivers of social and economic development. Advice on tax systems has been influenced by changing understandings of what drives development and particularly differing perspectives on the role of the state. During the period immediately after the second world war, there existed an optimism about state's role in tailoring strategies for wider economic management in the pursuit of

state-led industrialisation. Tax policy, and in particular trade taxation, was one of the levers governments could use to this end. However, this changed by the 1980s with the retreat of state-led development. Later on, the state was brought back in but in a different form, leading to an emphasis on 'good governance' and the administration of the tax system.

- Changing theoretical perspectives on tax systems in the West. International discourses on what makes an effective tax system have tended to be dominated by perspectives from the United States and Europe. For instance, Keynesian ideas were dominant after the second world war. 'Optimal tax theory', focused on the efficiency of tax systems came to play a much more influential role, when perspectives in development shifted towards marketed-oriented reforms. In the 1990s, new institutional economics and new public management influenced tax administration reforms.

While linking changes in ideas about taxation to these two evolutions allows us to make sense of what we observe, it should be noted that these are not always entirely mutually exclusive. Nor are they always both equally important. Moreover, this two-way classification is somewhat simplistic and ignores the complex interactions which hide behind these paradigm changes in taxation. Broader political and ideological configurations have to be taken into account (Kuhn, 1962). Therefore, the paper places these debates in a broader context of evolving (academic) ideas, real-world events and changing political realities. In other words, we underline the historical specificity of ideas about tax system reform in developing countries.

The world wars, the oil shocks and debt crises, the end of the Cold War and so on: these have all had a considerable impact upon the understanding of the role of the state in economic management more broadly, and tax policy in particular. Moreover, at times they provided the window of opportunity in which policy makers and advisers could draw ideas from academic disciplines including macroeconomics, public economics, political economy and public administration. Advisers have drawn from Keynesian ideas in the 1950s and 1960s, over to principles of neutrality in the 1980s, to good governance at the turn of the century, and a recognition of the role of state and society in the fiscal contract most recently. These ideas have all had an impact on how the international community has approached tax reform in developing countries.

Table 1 summarises some of the key trends discussed in this paper. It shows that throughout the past century, there has not always been a linear development in ideas, but rather certain perspectives seem to have been cyclical. For instance, questions over the respective roles of the state and market have oscillated in response to economic crises. In the early 20th century, the dominant thinking around economics was *laissez-faire*, but the Great Depression and the second world war saw a more

activist role for the state. The oil crisis of the 1970s saw the state retreat, while the financial crisis of 2007–08 has once again raised questions about the role of the state in economic management. Similarly, ideas about the role of international advisers in supporting taxation reform also seem to be returning towards some of the ideas common in the period immediately following the second world war. There is a growing view that advisers should not simply present a fixed set of best-practice reforms, but rather consideration needs to be given to specific political and institutional settings. This is very much in keeping with the approach of the institutionalist school looking at questions of taxation in the mid-20th century.

What lessons then can be learnt from this evolution of thinking towards taxation? In the final section of this paper, we distil three lessons. First, the strong and

continued influence of ideas from the Global North on reforming tax systems may not necessarily be what is most appropriate given the needs of developing countries. Caution should be taken in uncritically replicating specific reforms, as well as the approaches taken to reform planning and implementation. Second, more could be done to help advisers and governments distinguish between the ‘custom-built’ and the ‘bad idea’. Gearing research efforts towards contextualising tax reform experiences in order to not only understand what works, but why it works would be a useful step. In addition, there could be value in paying more attention to ‘outliers’. Third, international technical assistance needs to be designed in a way that allows for ‘custom-built’ approaches to support sustainable and effective tax reform.

**Table 1 Historical overview**

Period	Major events	Theories of development	Theories of taxation	International advice on reforming tax systems
1920s–1945	First world war and Great Depression	Promoting economic development not an explicit policy agenda. International relations start to be influenced by rethinking the role of state.	Decline of laissez-faire emphasising minimal taxation. Emergence of institutionalist school more concerned with social welfare.	US financial missions primarily concerned with ‘financial interests’, but equity considerations start to emerge.  In colonies, taxation about muddling through and ‘crisis management’.
1945–1970s	Second world war and decolonisation	‘Development economics’ emerges as a field of study: promotes state-led capital accumulation to foster economic development.	Different schools of thought coexist. Structuralists see tax policy as a tool to promote industrialisation through import substitution.	Tax advice (from the US) influenced by Keynesian and institutionalist perspectives of advisers. Often diverged from actual practices of using taxation to promote industrial development.
1980s	Oil shocks, debt crises	Washington Consensus asserts that state intervention and policies that distort markets are primary barrier to development.	Principle of neutrality dominates tax reform. Tax policy should be non-distortionary and allow markets to promote development.	Promotion of value-added tax to compensate for reduced trade taxes. Financing budgets through ‘seigniorage’ also criticised.
1990s–2000s	Policy failures, end Cold War	Washington Consensus complemented with a focus on ‘good governance’ and strengthening ‘institutions’.	Principle of neutrality remains in tax policy reform, but tax administration reform becomes more prominent and can support wider improvements in ‘governance’.	Tax policy advice largely unchanged, but a raft of administrative reforms introduced including semi-autonomous revenues authorities, large taxpayer offices and improved taxpayer services.
2010s	Global financial crisis	A move away from grand theories of development towards coming up with more robust empirical answers to smaller, more manageable questions. Shift in focus from institutional blueprints towards understanding how institutional change happens. The role of politics also becomes more prominent.	Renewed recognition that context matters and second or even ‘third-best’ tax policies might be appropriate in certain contexts.  Greater focus on questions of international tax and losses from tax evasion and tax avoidance.	Greater tolerance for tailoring reform to context and increased use of diagnostics to pinpoint weaknesses.  Taxpayer data and experiments to generate insights that can improve tax compliance.  International taxation becomes major area of focus.

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# 2 1920–40s: from laissez-faire to institutionalism

The start of transnational tax reform is often situated in the period following the second world war with the seminal missions of Carl Shoup to Japan (1949–50) and Venezuela (1958–59), and of Richard Musgrave to Colombia (1968) and Bolivia (1976). The legacies of these pioneering missions have had lasting effects on transnational tax missions for much of the second half of the 20th century.<sup>2</sup> However, thinking about tax reform had already transcended national borders before. It is useful to briefly go back to the pre-war period to explore how policy discussions in the aftermath of the second world war and at the moment of the independence wave were shaped by events and ideas from the inter-bellum period.

## 2.1 Drivers of social and economic development

In Europe and the United States, the end of the first world war ushered in *The End of Laissez-Faire*, according to Keynes (1926), although ideas about the role of government in the economy had been under pressure before. Powerful critiques from the Catholic Church and an emerging Marxist school of economics had called for more government intervention to mitigate the worst excesses of laissez-faire capitalism in the late 19th century (Tanzi, 2011). Nevertheless, it was the extensive wartime economic controls which strengthened the idea of direct state participation in production. Citizens started to demand more from the state for which many had given their life, while economists like Wagner and Von Schmoller provided the intellectual justification for a shift from a Smithian minimalist government to a state that redistributes wealth. Moreover, the turbulent and crisis-struck inter-war years which resulted in mass-unemployment not only called into question the efficiency of the market system, but also put pressure

on governments to act to avoid civil unrest. In response, governments increased public expenditure from about 13% of national income in the pre-first-world-war period to roughly 20% in the 1920s (Tanzi and Schuknecht, 2000: 7). The period saw the introduction of Keynesian ideas as well as the first steps towards the post-second-world-war welfare states, with programmes such as Roosevelt's New Deal in the US.

## 2.2 Changing theoretical perspectives of taxation

Ideas about the role of taxation in the economy were heavily influenced by economists from the American institutionalist school. They believed that redistributing economic power was a desirable objective of tax policy. They reasoned that decreasing inequality could increase trust in government, thereby increasing compliance and hence strengthening the fiscal (and borrowing) capacity of states (Brownlee, Ide and Fukagai, 2013). This would not only support state-building through revenue contribution but would also give citizens a stake in the process of governance, fostering the development of democratic values in society. However, in line with the Gladstonian legacy, they were cautious of debt financing as this was considered hidden (future) taxation. They paid particular attention to the interdependence of tax theory, tax administration and institutions. Their tax policy stance can roughly be summarised as, first, a recommendation for a comprehensive, broad-based tax system that treats similarly situated taxpayers similarly; second, and flowing from the first, a tax system should be neutral with regard to the economy and economic development; and third, that it is the level of economic development which shapes the socio-economic and administrative realities in which tax policy operates (Mehrotra, 2013).

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2 See Bahl and Bird (2008) for a reflection.

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## 2.3 The nature of tax ‘advice’

In the first part of the 20th century, financial missions, of which tax assistance was but one component, were mostly carried out in Latin America to ensure that debtor countries were in a position to repay their creditors, also known as ‘money-doctoring’ (Flandreau, 2005). As the US became the largest creditor, international tax experts were often economists from the American institutionalist school. While financial interests prevailed during their missions, equity concerns gradually filtered into their advice as well. Progressive income taxation was often favoured over indirect taxation, which was considered regressive. Moreover, income tax was believed to foster the development of democratic values in society. Policy recommendations, however, did not cling exclusively to theory but took into account the specific milieu in which they would be administered. In line with their heritage from the German Historical School, the institutionalists believed that public finance and taxation had to be understood from a historical perspective combined with detailed empirical investigation. In Cuba, for instance, this resulted in a recommendation for a presumptive instead of a comprehensive income tax (Adamson, 2013). Therefore, optimal tax policy was a rather relative concept taking into account economic, administrative and political realities.

## 2.4 Taxation in the colonies

In the colonies, administrators were trying to put in place tax systems that met the demands of the metropole but also maintained stability in the colony. Traditional arguments often depict colonial taxation, particularly in sub-Saharan Africa, as a despotic process of extracting surplus at the expense of the local population (Acemoglu, Johnson and Robinson, 2001; Mamdani, 1996; Young, 1994). While extraction was definitely a primary goal, colonial tax systems did not remain immune to social pressures and changes in thinking about taxation.

Colonial tax systems varied widely, both within and across colonial empires (Frankema, 2011; Frankema and van Waijenburg, 2014; Mkandawire, 2010). While colonial fiscal policy was heavily influenced by the metropole, the metropole seems to have been incapable of completely dictating it, as local political and economic realities were binding. According to Gardner (2013: 74), colonial taxation is better described as an almost constant ‘exercise in crisis management’. Until the first world war, Gardner argues, most colonies were run according to Gladstonian principles – small governments on balanced budgets – not because of

ideology but out of necessity. To avoid draining the metropole’s public finances, the colonies were meant to be self-sufficient. However, colonial revenue-raising was heavily constrained by weak economic activity, which in turn limited the amount of spending. Moreover, colonial administrators were reluctant to run deficits because grants-in-aid from the metropole came attached with stringent conditions, further eroding the already limited colonial autonomy (Gardner, 2013).

This changed in the inter-war period as result of the volatility in global economic markets. The turbulent global economic environment also led to changing demands on the state in the colonies. Active promotion of social welfare became a more important part of colonial governance, as illustrated in the adoption of the Colonial Development Act by the British Parliament. However, adequate funding continued to be an issue as metropolitan governments were equally struggling with their own public finances.

Crisis management and volatile trade revenues pushed colonial administrators to continuously seek new sources of revenue. In line with evolutions at home, they increasingly turned to progressive taxation.<sup>3</sup> Gardner (2013: 51) cites a number of colonial records which explicitly mention the need to ‘avoid any attempt to collect tax which was more than Africans were capable of paying or more than believed was the value of the services the colonial administration was providing’. Underlying this lay the realisation that the alternative would result in increased demands on the colonial state that could not be met and would potentially result in a costly rebellion. In the British Empire, hut taxes<sup>4</sup> were gradually replaced by poll taxes, but significant exemptions were allowed. Collection was only extended and increased after taking into consideration ‘the ability of the people to pay...on account of their proximity to labour-employing centres, and their geographical position from the point of view of economical administration’ (Gardner, 2013: 55). Striking the right balance between revenue raising, administrative capacity and progressivity would remain a difficult exercise throughout the colonial and post-colonial period (Fjeldstad and Therkildsen, 2008). Colonial fiscal policy thus reflected the wider changes in ideas about the role of government in the wake of the turbulent inter-war years. Nevertheless, overall the fiscal capacity and reach of the colonial state remained very limited due to local economic, political and administrative realities.<sup>5</sup> Despite various efforts, colonial taxation continued to rely on easy-to-administer trade revenue. This would have implications for post-independence state-building and development.<sup>6</sup>

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3 This search for progressiveness sometimes led to peculiar forms of taxation: ‘The British tended to levy head taxes or poll taxes on each adult male ... these were complemented by a “multiple wives tax” to make taxes somewhat more progressive’ (Frankema and Van Waijenburg, 2014: 389).

4 A tax payable per dwelling regardless of the number of household members.

5 Herbst (2000), for example, points out that many interpretations of European colonialism significantly overestimate its power and scope.

6 For a contrasting case where a strong tax administration was left behind after colonisation, see Kohli (2004) on South Korea.

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# 3 1950s–1970s: taxation as a tool in the pursuit of state-led development

Often talked about as the ‘Golden Age’, developed countries enjoyed relative economic stability in this period. Keynesian ideas dominated thinking about public finance. The role of government, and taxation, was to support stabilisation, but also redistribution. At the same time, the international decolonisation wave brought many new nations into existence. Set to use their newly found independence to spur local development, these states intervened massively in the economy, often resulting in initially quite impressive economic growth rates. Taxation became an instrument of the state to support economic development.

## 3.1 Changing perspectives on development

### 3.1.1 Keynesian stabilisation in the West

In the aftermath of the second world war, governments in the US and Europe were under pressure domestically to compensate workers for their sacrifices during the war (Tanzi, 2011). Moreover, there existed a ‘spirit of policy-optimism...derived from the wartime demonstration of what could be achieved by the mobilization of resources’ (Meier, 1984: 15). The perceived success of socialist and communist planned economies put further pressure on governments in the rest of the world. This had a strong influence on the perceived role of tax and spending policies: public expenditure continued to rise to about 28% of GDP in the 1960s and kept increasing as Western welfare states reached their peaks (Tanzi and Schuknecht, 2000).

The demands on the state in the post-war period saw Keynesian ideas about an activist fiscal policy really

taking off. Richard Musgrave (1959), in his seminal public finance textbook, listed stabilisation (ensuring full employment) and distribution (redistribution of income) alongside allocation as the core policy goals of tax and expenditure.<sup>7</sup> This implied a departure from Gladstonian public finance, as running deficits became an accepted means of stabilising falling aggregate demand in order to achieve or maintain full employment. This idea was further popularised by J.K. Galbraith in his influential book *The Affluent Society* (1958). Although not without opposition, the role of the state as a central and proactive actor in the economy had become entrenched.

### 3.1.2 The birth of development economics in the South

Immediately after the second world war, economic development as such was not part of the UN’s agenda, because the US and UK were bickering over trade and employment.<sup>8</sup> However, with Europe in shatters and increasingly louder demands from the colonies and newly independent states to raise living standards, economists (re)turned their attention to the question of economic development. State-led capital accumulation would allow ‘economically backward’ nations to quickly catch up with the industrialised ones (Gerschenkron, 1962).<sup>9</sup> Nevertheless, it was only when a favourable business cycle made issues of trade and employment less pressing in the industrialised nations that the issue of underdevelopment rose up the political agenda. It came to be seen as a political opportunity to bring the West together at a time when the Cold War was turning into a real war in Korea (Daunton, 2013; Toye and Toye, 2006). According to Gerald Meier, (1984: 8) ‘the pedigree of Development Economics’ can be read as ‘by Colonial Economics out of Political Expediency’.

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7 Shoup (1969), in his textbook, considered full employment as one of two criteria to measure economic efficiency, the other being excess burden.

8 The years immediately following the second world war were characterised by intense debates about trade and full employment. While returning to free trade seemed desirable, because of the perceived contribution of inter-war protectionism to the onset of war, the US and the UK were at loggerheads at Bretton Woods over how best to achieve this (Daunton, 2013). See also Steil (2013) for a detailed account of the ‘Battle for Bretton Woods’.

9 Capital accumulation through planned saving and investment, in combination with readily available labour from the ‘agrarian excess population’ was believed to be the key to catch-up development (Harrod, 1939; Rosenstein-Rodan, 1943; Domar, 1946; Lewis, 1954).

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In 1951 the UN published its highly influential *Measures for the Economic Development of Underdeveloped Countries* (UN, 1951). It marked the birth of the new ‘development economics’ discipline. This report recognised the specific challenges facing poor countries in their attempt to catch up with the already industrialised nations. Heavily influenced by W. Arthur Lewis, it focused particularly on the need to increase capital accumulation in developing countries:

*‘The deficiency of capital applies in every sphere. Public works and utilities, roads, railways, power houses, telecommunications, waterworks, irrigation canals, hospitals, school buildings – all these are gravely deficient.’ (Lewis in Gardner, 2013: 145)*

In the same vein, the Economic Commission for Latin America (ECLA), where Raúl Prebisch was executive secretary, started propagating ‘structuralism’. In their view, problems of economic underdevelopment (e.g. inflation) did not arise from excess demand but rather from structural bottlenecks (e.g. a lack of diversification) in the economic system. They identified declining terms of trade for primary commodities as a key issue (ECLA, 1950; Singer, 1950).<sup>10</sup> Influenced by the optimism about the capacity of the state, planned industrialisation via import-substitution (ISI) was seen as the solution. The pre-eminent challenge was to transform economies – not, as in the Keynesian paradigm, to stabilise them.

## 3.2 The role of tax in development

These ideas around activist fiscal policy were reflected in the predominant thinking on the role of taxation in developed countries. According to Bird (2013), optimal taxation in developed countries was all about progressive income taxes. Following the Keynesian revolution and a belief in an active state, he summarised post-war taxation as: (1) an increase in the level of taxation, (2) increased progressivity, (3) comprehensive personal income tax, and (4) a view of consumption taxes as a necessary evil (Bird, 2013). This followed directly from the Keynesian doctrine that full employment could be guaranteed through publicly funded programmes.

In contrast, in development economics taxation was motivated by a concern with economic development and capital accumulation. The objective of taxation was to restrain non-essential consumption so that savings and therefore capital investment could be increased (Fitzgerald, 1978). Since non-essential or luxury consumption was found to be linked to higher income groups, there was an argument for increased progressivity. Income taxes were favoured over consumption taxes, as the latter were considered

less progressive. With regard to consumption taxes, a distinction was made between domestically produced consumption goods, which were considered developmental, and imported consumption goods, which were not. In line with the structuralist point of view, restricting import competition through import taxes would nurture industrialisation and diversification, and hence diminish the exposure of developing countries to volatile commodity markets (Heller, 1967). Export taxes, on the other hand, would allow the state to capture some of the surplus generated by commodity/agricultural booms to invest in the more productive industrial sector, or put differently: ‘Much money which the farmers would otherwise have spent on Cadillacs...has gone instead into water supplies, electric power stations, and schools’ (Martin and Lewis, 1967: 89).

## 3.3 Tax advice running counter to practice in the developing world

The period saw the rise of many bilateral and multilateral missions, the inauguration in 1952 of the International Program in Taxation at Harvard University, the creation of the Joint Tax Program in 1961 by the Organization of American States, the Inter-American Development Bank and the Economic Commission for Latin America, the establishment of the US Tax Assistance Program in 1962, and the birth of the IMF’s Fiscal Affairs Department in 1964. These early missions were dominated by academics such as Carl Shoup, Richard Musgrave, Nicolas Kaldor, Oliver Oldman, Richard Goode, Roy Bahl, Glenn Jenkins and Richard Bird, to name but a few. Increasing revenue collection through progressive income taxes was often central to these missions. Nevertheless, in line with most advisers’ institutionalist heritage, it was recognised that: ‘the effects of a tax depend on upon what is, not what it is meant to be’ (Musgrave, 1959: v). In other words, it required an understanding of the social and historical setting. However, tax policy advice often reflected what was in place in the adviser’s home country, or otherwise it involved theoretical concepts not accepted at home, but to be tried for the first time in developing countries (Bird, 2013).

Often, however, actual tax practice differed significantly from what was advocated by the international tax missions. Instead, ideas from development economics seem to have had more bearing on tax policy choices (see Table 2 for an overview).<sup>11</sup> Daunton (2013), commenting on the Shoup mission to Japan, notes that instead of adopting a broad-based direct tax system, Japan continued to favour tax breaks on savings in line with its industrialisation strategy. In general, reliance on direct taxation remained low across

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10 This is known as the Prebisch-Singer Hypothesis. See Toye and Toye (2003) for a review.

11 Goode (1993: 38) notes that: ‘Few of the early tax advisers were conversant with the relatively new field of development economics’ but adds that in light of later critiques of development economics this might not have been undesirable.

the developing world. Direct taxation was politically unpopular in newly independent states because of the coercive nature of direct taxation (e.g. poll taxes) under colonial rule (Moore, 2004b). Moreover, the reach of post-colonial administrations was often limited, which further limited the scope for direct taxation. When direct taxation was rolled out, marginal rates were often (extremely) high, but brackets were numerous and were combined with an array of exemptions (World Bank, 1988). Similarly, with regard to corporate income

taxation, advisers recommended sophisticated systems to integrate these taxes with personal income taxation. Yet, governments in developing countries were generally more interested in special incentives for investment in priority industries (Goode, 1993). When ideas did coincide, such as on progressivity, the underlying rationale often differed. While institutionalists favoured progressivity because of equity concerns, structuralists saw it as a tool to limit non-essential or luxury consumption.

**Table 2 Structuralist tax policy examples**

Tax	Rationale
Progressive income taxes	Restraining non-essential or luxury consumption, which is generally linked with higher income groups.
Import taxes	Taxing imported goods would encourage the development of the local sector and decrease exposure to global volatility.
Export taxes	Allow the state to capture some of the surplus generated by agriculture and commodity booms.
Inflation	Inflation acts as a tax on money. A legitimate form of temporary development finance when alternatives for mobilising and allocating savings were underdeveloped or unavailable (Gurley and Shaw, 1967). Could also incentivise investment following increased asset prices, and therefore spur economic development. <sup>12</sup>
Implicit taxation	Refers to an array of government price controls. <sup>13</sup> Examples include below-market-price compulsory procurement (as embodied in agricultural marketing boards). <sup>14</sup> Building on the Lewis model, ISI policies taxed agriculture heavily since it was implicitly assumed that, given the abundance of labour, agricultural labour supply would not respond to prices in the same way as it did in industrial economies. Moreover, they allowed to control domestic manufacturing costs by keeping food prices and thus wage demands in check.

12 See Bernstein and Patel (1952) for an early review of the potential contributions and dangers of inflation to economic development. The use of inflation in this way was nothing new, but it had fallen out of favour in advanced nations partly because of economic reasons and partly because of political reasons, as it favoured debtor nations (e.g. France) over creditor nations (e.g. the US) (Lynch, 2013).

13 All of these have tax-like effects in the sense that can be analysed within the same framework used to analyse explicit statutory tax rates (Rabushka and Bartlett, 1985). Though this did not always mean that resources were transferred to government, as big part of the rents generated were captured by interest groups.

14 To give but one example, Rabushka and Bartlett (1985: 38) estimated an implicit tax rate on bananas of 81% in Jamaica.

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# 4 1980s: the Washington Consensus and the return to tax neutrality

Although tax revenues increased throughout the early post-second-world-war period, they were not sufficient to cover the financing needs of developing economies.<sup>15</sup> On the back of strong growth and high commodity prices, developing countries instead supplemented their domestic savings with international borrowing and money printing in their push for industrialisation. By the end of the 1970s, debt burdens and inflation were spiralling out of control in much of the developing world. Initially backed by strong growth, these debt burdens did not seem problematic. However, a number of geopolitical events put them under pressure.<sup>16</sup> In 1971 the end of the gold standard and an increase in US interest rates reversed global capital flows, drawing them to the US and away from the developing world (Daunton, 2013). When the first oil shock hit in 1973-74, developing countries managed to adjust rapidly. In fact, the resulting surpluses of oil exporters were recycled into additional cheap loans, further contributing to debt-led growth (Krueger, 1987). But when the second oil shock hit in 1979-82, the boom years came to a sudden halt. With both inflation and unemployment increasing at once, the world experienced stagflation for the first time. OECD countries reacted by introducing anti-inflationary policies, thereby depressing the worldwide demand for commodities, leading to a global recession. What followed was one of the most severe debt and economic crises seen in the developing world.

## 4.1 Changing perspectives on development

The crisis had a profound impact on perspectives on the role of the state, and the function of the tax system in particular. Despite the importance of structural factors,<sup>17</sup> the events came to be interpreted as evidence that state-led development had led developing countries into the abyss (Lal, 2002; World Bank, 1981). At the same time, Keynesianism was unable to explain and deal with stagflation.<sup>18</sup> As a result, public discontent with state interventionism grew, especially in the US as illustrated by the popularity of books as *Atlas Shrugged* by Ayn Rand (1967) or *Anarchy, State, and Utopia* by Robert Nozick (1974). Governments and political parties were left looking for alternatives, which opened the door for a microeconomic counter-revolution.<sup>19</sup> Combined with increasing evidence on the internal contradictions of communist experiments, this resulted in a sharp political turn in favour of smaller government in much of the OECD. The conceptualisation of the state as a benevolent actor gave way to one in which the state was, at best, ineffective and, at worst, had a hidden agenda.

Government intervention, and therefore state-led development, was criticised on many fronts, but two critiques stand out: (1) negligence of the price mechanism and (2) a naïve perception of the state as only concerned with social welfare (Tanzi and Schuknecht, 2000). Robert Lucas's work (1972, 1983) was particularly influential in placing the microeconomic price mechanism back at the centre of economic analysis. A re-appreciation of welfare economics showed that, in theory, markets left to themselves could provide a welfare optimum (Arrow

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15 For Fitzgerald (1978), this shortfall in taxation was one of the fundamental causes of the crisis and was driven by an internal contradiction in the political economy of ISI.

16 Some of the seeds had already been planted by the USA's printing of dollars to finance the Vietnam war. This provided international liquidity, but also led to inflation elsewhere including in the developing world as the world was flooded with dollars (Helleiner, 2011).

17 See Diaz-Alejandro (1984) on the role of international financial markets in Latin America or Arrighi (2002) for a world-systemic analysis of the African crisis.

18 See Friedman (1968).

19 Anti-Keynesian sentiment had already gained a foothold in policy. Toye and Toye (2003: 28) describe UN Secretary-General, Dag Hammarskjöld, as an 'unexpected ally for the critics of extreme Keynesianism'.



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and Debreu, 1954). On the other hand, public choice theory reconceptualised government as a bargaining process which could be captured by self-interested interest groups (Buchanan and Tollison, 1972; Buchanan, Tollison and Tullock, 1980). Empirical evidence indeed showed that governments were not always acting in the interests of society. Overvalued exchange rates, for example, were linked to unproductive and corrupt rent-seeking through the administrative allocation of import licences (Krueger, 1974). Other development policies were often found to benefit only certain interest groups (Bates, 1983). Government meddling with the price mechanism, it was argued, had far more disastrous consequences than the market failures it was supposed to address (Lal, 2002). Instead, the allocation of resources had to be returned to the market through macroeconomic stabilisation (i.e. demand reduction) and trade liberalisation in order to rekindle economic growth (Toye, 2003). The key was to ‘get the prices right’.

## 4.2 The role of tax in development

This sharp turn in thinking about the nature of the state had significant consequences for the role of taxation in the economy. Instead of a tool of industrialisation, taxation turned into a distortion of prices that was to be kept to a minimum in order for the market to do its job. A full review of the optimal taxation literature is beyond the scope of this paper, but some of the most significant implications are highlighted.<sup>20</sup>

The general conclusion emerging out of this literature was that tax policies should be justified on the basis of a clear cost/benefit analysis. This had important implications, especially for the taxation of intermediate goods. Taxes on inputs should not vary across sectors, as that would alter incentives for their use, resulting in a loss of production efficiency (Diamond and Mirrlees, 1971). With regard to income taxation, little evidence was found in support of very progressive structures regardless of the weight put on the least well-off (Atkinson, 1973; Mirrlees, 1971; Stern, 1976). However, the academic literature was careful to avoid generalisations. While findings went against (protective) trade tariffs on intermediate goods, it was recognised that the elimination of tariffs was a long-term goal that should be pursued only as and when revenue from final goods could be increased. Moreover, the underlying theoretical models, crucially, depended on a number

of simplifying assumptions.<sup>21</sup> Additionally, while efficiency concerns implied a uniform rate for indirect taxes, distributional concerns could under certain circumstances justify varying rates (Burgess and Stern, 1993). Nevertheless, the idea of an overarching principle of neutrality was born.<sup>22</sup>

This emphasis on neutrality was fundamentally at odds with the structuralist thinking about taxation. Under structuralism, tax policy was considered a tool of state intervention in the economy, explicitly aimed at distorting prices to favour certain activities over others in the pursuit of industrialisation and economic development. However, as the challenges to the state-led development grew, so did the criticism of the corresponding tax policies. Evaluations of ISI tax policies, such as the ones by Rabushka and Bartlett (1985) or Tanzi (1991), raised a number of issues. Table 3 gives a taste. Nearly all could be brought back to the principle of ‘violating the principle of neutrality’.

## 4.3 Tax advice leads changes to practice in the developing world

The debt crisis also led to far-reaching changes in the relationships between governments and international organisations. International creditor organisations such as the IMF and World Bank came to play a more central role, at the expense of the UN. The nature of international development cooperation shifted. According to some, it came resemble the sorts of economic stabilisation programmes seen at the end of the 19th century, mainly interpreted as attempts at safeguarding the borrowing capacity of developing countries (Brownlee and Ide, 2013). This resulted in the ‘Washington Consensus’ on economic policy.<sup>23</sup> IMF and World Bank lending were conditional on governments adopting more market-oriented policies. Embodied in Structural Adjustment Programs (SAPs), this led to mass privatisation, liberalisation and a push for a minimalist government concerned only with law and order, education and health (Toye, 2003). Consistent with these developments, the Bretton Woods institutions came to play a much more dominant role in shaping the direction of reform of tax systems. The fiscal component of the Washington Consensus held that the main role of tax policy was to raise revenue, rather than to direct economic activity (which was the role of the market). Tax policy had to be neutral and simple: i.e. broad-based

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20 For a detailed discussion see Ahmad and Stern (1989) or Burgess and Stern (1993).

21 As Slemrod (1990: 164) notes, this recalls to mind the words of Edgeworth: ‘Only a clever man would discover that exceptional case [on Marshall’s Giffen good]; only a very foolish man would take it as the basis of rule for general practice’.

22 Tax policies should minimise their distortive effects on economic choices. Note that this also implies eliminating tax incentives, such as tax holidays, exemptions, etc., previously aimed at promoting industrialisation. Though concerns about equity and externalities can, if first-best assumptions do not apply, justify divergence from this principle.

23 The Washington Consensus originally described ten reforms that were broadly deemed appropriate for Latin American countries in the late 1980s. However, Williamson (2004) argues that over time different ideas were projected onto it.

**Table 3 Critique of structuralist tax policy**

Tax	Critique
Progressive income taxes	Top marginal income tax rates were often above 50%, and usually riddled with exemptions (Ahmad and Stern, 1991; World Bank, 1988). This violates the principle of neutrality because it favours agricultural (informal) income over monetised (formal) income, and hence discouraged modernisation (Bauer and Yamey, 1957). Moreover, high rates were likely to affect the entrepreneurial class in particular (Rabushka and Bartlett, 1985).
Import taxes	Often resulted in domestic monopolies generating significant rents benefitting only a narrow set of interest groups (Krueger, 1974). Moreover, given the extent of corruption involved, import licensing tended to redistribute income from government, which loses tax revenue, to importers, who receive rents (Tanzi, 1991).
Over-valued exchange rates	Act as tax on tradable goods, discouraging exports and leading to foreign exchange shortages (Krueger, Schiff and Valdés, 1988). In addition, if the tax base for import or export ( <i>ad valorem</i> ) taxes is expressed in the domestic currency, as it usually is, then this will shrink the real value of the base.
Inflation	Fundamentally distorts the price mechanism. Moreover, it poses risks specific to taxation. First, if collection gaps, i.e. the time lag between the moment when the tax becomes due and the time it is collected, are important, as is usually the case in developing countries, then inflation will erode the real value of tax revenues (Tanzi, 1977). Second, as prices increase, taxes expressed in fixed rates, as opposed to <i>ad valorem</i> rates, will generate comparatively less revenue (Tanzi, 1983).
Implicit taxation	Various studies found that farmers in developing countries respond in the same way as in industrialised countries, i.e. supply is lower when output is taxed (Cleaver, 1985; Lal, 1976). Moreover, it gradually became clear that these controls were not only economically motivated, but also politically. Lower food prices allowed politicians to protect and favour urbanised interest groups, known as urban bias (Bates, 1983).

with low and preferably uniform rates (Bird, 2013).<sup>24</sup> If this could be achieved, then these ‘supply-side policies’ would contribute to ‘removing all the obstacles on the way to growth’ (Tanzi, 1991: 180).

#### 4.3.1 From trade taxation to VAT

The implications for international tax policy advice were significant and are well summarised in a paper by the IMF’s Fiscal Affairs Department (Tanzi, 1990).<sup>25</sup> The main shift was away from direct and trade taxation and towards increased taxation of consumption. Consistent with developments in richer countries, the World Bank and IMF recommended to developing countries replacing their high direct tax rates with lower uniform rates, levied on broader bases, getting rid of the multitude of tax incentives or exemptions (Goode, 1993; Thirsk, 1991). At the same time, trade taxation, while historically the most important tax handle in developing countries, had to be decreased. Export taxes were considered particularly problematic by the IMF because of their negative impact on foreign exchange earnings.

While import duties were initially still tolerated, though at lower levels and preferably as *ad valorem* tariffs instead of quotas, the IMF had a clear preference for replacing them with domestic indirect taxes (Tanzi, 1990).

To counterbalance these reductions in direct and trade taxes, reliance on consumption taxes, and in particular Value Added Tax (VAT), increased. The introduction of the VAT has become the most visible and significant change in modern taxation.<sup>26</sup> In line with the principle of neutrality, firms only pay tax on the value added of their products. This way, the VAT ‘untaxes’ intermediate goods, and thus also exports. Moreover, it places imports and domestic production on the same level and is thus neutral with respect to production decisions.<sup>27</sup> Experiences in Europe, where it was first introduced in the 1940s, seemed to confirm that VAT could replace trade taxes while facilitating trade.<sup>28</sup> VAT thus became the preferred consumption tax.<sup>29</sup> If properly designed and implemented, VAT was predicted to significantly increase the government’s tax take.<sup>30</sup>

24 Known elsewhere as the BBLR (broad based low rate) model (Bird, 2011).

25 Vito Tanzi (1990: 4) acknowledges that IMF policy is indeed impacted by events and new ideas: ‘In the 1960s, high tax levels, highly progressive income taxes, and extensive government intervention in the economy were fashionable, both politically and academically. In the 1980s, supply-side and public choice thinking, and the prevailing view that large public sectors and extensive governmental intervention may have negative effects on economic performance, could not fail to influence Fund staff and, thus, its approach to tax reform.’

26 The rapid and seemingly irresistible rise of the value-added tax (VAT) is probably the most important tax development of the later 20th century, and certainly the most breath-taking’ (Ebrill, Bodin, Keen and Summers, 2001, p. xi).

27 See Ebrill et al. (2001) for a full discussion of VAT design.

28 For example Ebrill et al. (1999) or Keen and Lighthard (2002).

29 See Bird and Gendron (2007) for a full review of the VAT and for a comparison with other consumption taxes.

30 ‘Properly designed’ here means that the VAT should have a uniform rate and minimal exemptions, should be broad-based and that there should not be any domestic zero-ratings (Tanzi, 1990; Thirsk, 1991). IMF studies predict that in low-income countries VAT can be expected to raise an extra 2% of GDP in tax revenue (IMF, 2011).

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### 4.3.2 A truly global change

As a result of the dominance of the Washington Consensus in fiscal reforms, more than previous rounds of international tax advice, this tax reform agenda went global.<sup>31</sup> While during the early 1970s only a handful of countries adopted VAT, by the turn of the millennium the number had reached closer to 120 (Keen and Lockwood, 2010). At the same time, nominal trade tariffs were often more than halved and income tax rates declined across the developing world (Greenaway, Morgan and Wright, 2002; Peter, Buttrick and Duncan, 2010). While the spread of these reforms has to be understood in light of the broader historical context and changing ideas about economic policy and taxation described above, the immediate drivers were the international financial institutions. From the mid-1980s onwards these tax reforms became important parts of the conditionalities attached to World Bank and IMF lending and WTO membership, which contributed to their widespread adoption (at least in name) (Stewart, 2003; Stewart and Jogarajan, 2004).

Bahl and Bird (2008) point out some important consequences in the nature and approach to tax reforms. In the period after the second world war, international tax advisers were scholars, like Shoup, Musgrave or Kaldor, who studied, often at the invitation of the country, specific tax systems and took into account local conditions to provide context-specific solutions. This changed, and the second group of international advisers can be best described as an increasingly uniform ‘epistemic community of tax professionals’ (Fjeldstad and Moore, 2008: 240). Employed often by bilateral donors and international agencies, their objectives were narrow and often set ‘in response to the political imperatives under which they operated’ (Bahl and Bird, 2008: 286). According to Brownlee and Ide (2013), this resulted in a rigid, ‘one-size-fits-all’ reform model.<sup>32</sup> These new developments in international support for tax reform were not universally seen as a good thing: prominent contemporary tax scholars, notably Richard M. Bird,<sup>33</sup> called for greater contextual awareness when designing tax reform programmes – in other words an institutional approach.

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31 For a review of country-specific examples see, among others, Ahmad and Stern (1989, 1991), Bird and Oldman (1990), Burgess and Stern (1993) or Gillis (1989).

32 Richard Gordon, for example, criticised Harvard’s Basic World Tax Code because ‘even those policies that are generally accepted as a matter of theory may not be appropriate in a particular situation ... and the best legislative embodiment of even a single policy will differ depending on the particular situation’ (Gordon, 1996: 930).

33 Richard M. Bird, himself a student of Carl Shoup, concludes his book *Tax Policy and Economic Development* as follows: ‘The lure of the new – computerisation, value-added taxation...or whatever – is always great. One can only hope that at least some governments will be strong enough, and wise enough, to cease chasing after fundamentally non-existent panaceas to their fiscal problems and to begin paying adequate attention to such mundane but important concerns as those emphasised here [referring to the country-specific nuts and bolts of tax reform]’ (Bird, 1992: 214).

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# 5 1990s–2000s: institutions, good governance and the importance of tax administration

The end of the Cold War and the failure of the SAPs led to a questioning of the paradigm of the minimal and non-interventionist state introduced in response to the apparent government failures of the 1970s. Gradually, a new consensus emerged which concluded not that the previous round had been wrong, but rather that the necessary preconditions for successful implementation were not in place in most developing countries, in particular good institutions and good governance. By the turn of the century, strong states were considered a necessary condition for strong economic performance. Instead of substitutes, state and market came to be seen as complements. Core principles, such as the focus on prices, were retained, augmented with a governance agenda (World Bank, 1997). Policy advice moved from ‘getting the prices right’ to ‘getting the institutions right’. While the economy should be guided by market principles, states had to ensure stable institutions, in particular the liberal Western type, and a level playing field in which markets could operate and flourish.

## 5.1 Changing perspectives on development

By the end of the 1980s, it had become clear that SAPs were not having their desired effects (Cornia, Jolly and Stewart, 1987, 1988; Mkandawire, 1988). Economic performance had disappointed and tax-to-GDP ratios were falling. In addition, the end of the Cold War opened the door for a more critical debate within the

international financial institutions about the respective role of the state and the market. The academic and policy mainstream started exploring reasons for these failures, which resulted in a reconsideration of the role played by the state within economics. As Toye (2003) notes, much of this work had been done earlier but could only surface because of the window of opportunity provided by the end of the Cold War.

Many of the answers were found in New Institutional Economics (NIE), which was inspired by the seminal contributions of Douglas North (1984, 1987) and built on Ronald Coase’s work (1937, 1960). It underlines the dependence of economic performance on a country’s institutional framework (often termed ‘the rules of the game’).<sup>34</sup> The central problem of economic policy was considered to be its credibility, as argued by Finn Kydland and Edward Prescott (1977). Discretionary rules result in time inconsistencies because policy makers face an incentive to renege on their policies once they are put in place. Therefore, ‘good’ institutions boost economic performance by increasing policy credibility by tying the hands of policy makers.<sup>35</sup> Running in parallel to this interest in the economic literature was a growing interest in New Public Management (NPM) among public administration scholars. The rise of the NPM paradigm asserted that public administration could be made more effective and efficient, and less costly, if it was run more like a business, placing customer service at the centre of the organisation (Hood, 1991). In line with the NIE focus on policy credibility,<sup>36</sup> service delivery would

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34 See Harriss, Hunter and Lewis (2003) on *New Institutional Economics and Third World Development*.

35 It has been referred to as ‘governing without a government’, see Rhodes (1996).

36 See Hood (1991) on NPM as the outcome of a marriage between New Institutional Economics and Managerialism.

improve most if policy and implementation functions were separated, resulting in a recommendation for the privatisation, 'autonomatisation' or 'corporatisation' of public services (Manning, 2001).

Research into institutions exploded and the broad consensus was that (Western) liberal institutions were best in terms of promoting economic growth.<sup>37</sup> Conversely, sluggish economic performance was blamed on institutional weaknesses, such as corruption and political patronage.<sup>38</sup> What was supposedly missing in developing countries was 'good governance' (Kaufmann, Kraay, and Zoido-Lobaton, 1999; World Bank, 1992). Good governance research underlined the importance of an efficient, accountable and open government with a strong emphasis on the rule of law (World Bank, 1997). The conceptualisation of the state in development thus shifted again. While many were still sceptical about full-blown state intervention, an effective state was now regarded a necessary precondition for efficient markets.

## 5.2 The role of tax in development

In the same way as the SAPs had had ambiguous effects on economic performance, the fiscal component of the Washington Consensus had not had the hoped-for effect on tax revenues. Instead of broadening the base, trade liberalisation took away a key tax handle and depressed tax revenues throughout the developing world (Khattry and Rao, 2002; Nashashibi and Bazzoni, 1994). Increased reliance on indirect taxation, and in particular on VAT, did increase revenues modestly (Keen and Lockwood, 2010),<sup>39</sup> but was not able to offset trade revenue losses (Baunsgaard and Keen, 2005). Moreover, Bird (2004) observes that even in places where reform seemed successful at first, reality often changed less than the tax statistics suggested. Looking back, Fjeldstad and Moore (2008: 43) conclude that:

*'In respect of total government revenues, the global tax reform agenda has failed the poorer*

*countries. It has not lived up to the promise of delivering the revenues that they undoubtedly need through replacing trade taxes with VAT and by broadening the income tax base while lowering rates.'*

In line with the broader shift to a focus on institutions and governance, much closer attention now went to the administration of tax collection (Barbone, Das-Gupta, De Wulf and Hansson, 1999; Ghura, 1998). This put into question the practical value of some of the earlier optimal tax literature, emphasising the administrative challenges it involved.<sup>40</sup> Joel Slemrod, in his influential review (1990: 168), notes that: 'If optimal tax theory is to be a reliable guide to action, it must consider the issues that arise in operating the tax system.' While it did not disagree with the specific policies, this new literature took issue with the assumption of 'costlessness' in optimal tax theory, i.e. that both the administration and the payment of taxes do not involve frictions or costs.<sup>41</sup> New research instead modelled and estimated the collection cost for governments (Mayshar, 1991; Slemrod and Yitzhaki, 1994; Sandford, 1995) and also demonstrated the importance of compliance costs to individuals and companies, which led to new insights regarding tax evasion and avoidance (Blumenthal and Slemrod, 1992; Murray, 1995; Slemrod and Blumenthal, 1996; Slemrod and Yitzhaki, 1996; Andreoni, Erard and Feinstein, 1998; Alm, 1999).<sup>42</sup> Overall, the notion of a tax gap gained a central place in these analyses,<sup>43</sup> and research subsequently focused on technical solutions to close this gap with minimal waste and effort.<sup>44</sup>

Moreover, previous studies assumed perfect information and the availability of a full set of tax instruments. While these assumptions are already a stretch in the case of rich nations, they are even more so for developing countries, with their limited tax administrations (Heady, 1993, 2004; Bird, 1992). Not only do resource constraints put limits on the proper staffing of administrations, but poor education and

37 See for example Acemoglu, Johnson and Robinson (2001) on private property rights, La Porta, Lopez-de-Silanes and Shleifer (2008) on the importance of a common-law legal system, Rodrik, Subramanian and Trebbi (2002) on the importance of institutions compared to geography and trade, and Acemoglu, Naidu, Restrepo and Robinson (2014) for a recent take on democracy. The causal effect from democracy on economic performance was often unclear in earlier studies (e.g. Barro, 1996). Instead, democracy was argued to be a meta-institution that elicits and aggregates local knowledge and thereby helps to build better institutions (e.g. Rodrik, 2007; Sen, 2001). The relationship between democracies and taxation is equally unclear, see Boix (2001), Cheibub (1998), Fauvelle-Aymar (1999) or Garcia and Von Haldenwang (2016).

38 See Shleifer and Vishny (1993) for their seminal article on corruption. On political patronage in Africa see Chabal and Daloz (1999) or Van de Walle (2001).

39 The positive revenue impact of VAT in sub-Saharan Africa was recently put back into question, see Ahlerup, Baskaran and Bigsten (2015).

40 Or as Casanegra (1990) put it, 'in developing countries tax administration is tax policy'. While concerns about the administration of the tax systems had always troubled tax scholars and practitioners, only now did they move from the periphery to the centre of the debate. For earlier discussions see for example Surrey (1958), Hinrichs (1966), Musgrave (1969) or Bird (1989).

41 See Alm (1996) for an excellent review.

42 Compliance cost is a concept that measures how much time and effort has to be exerted to conform with tax regulations.

43 The tax gap is the difference between actual tax revenue and what should be collected given the existing tax law.

44 One particularly interesting idea is that there is no such thing as a single optimal tax system even within a country, because the optimal tax system is dependent on the technology of tax collection. Given that the evolution of technology changes over time, the optimal tax system is, therefore, necessarily dynamic (Slemrod, 1990).

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record-keeping also contribute to increased discretion on the part of the tax official, opening up possibilities for corruption (Chander and Wilde, 1992; Flatters and Macleod, 1995).

The conclusions emerging from these two complementary bodies of literature were twofold. The first was a focus on reducing compliance costs through emphasising customer-oriented service delivery and better enforcement. The standard prescriptions to deal with compliance, i.e. increasing audit and penalty rates, were based on analyses by Allingham and Sandmo (1972) and Srinivasan (1973) and rooted in the economics-of-crime literature.<sup>45</sup> The second pointed to decreasing collection costs via the simplification of the tax system and the modernisation of revenue administrations.

### 5.3 Tax advice to developing countries incorporates strengthening 'institutional capacity'

The focus of the advice of the international community thus moved to improving domestic institutional capacity, which was put at the heart of international lending programmes. This was particularly noticeable in field of public expenditure management. Andrews (2013) finds that before the 1990s fewer than 1% of World Bank projects featured governance reforms, while by 2010 this was closer to 65%. This also extended to tax administration. While it had hardly featured in the 1990 review, in 2000 tax administration was listed by the IMF as the second most important challenge to the establishment of efficient tax systems in developing countries.<sup>46</sup> While the fiscal policy aspects of the Washington Consensus were preserved within the so-called 'epistemic community of tax professionals', they were 'augmented' with an emphasis on tax governance and administration.<sup>47</sup>

The influence of the 'good governance' debate saw a convergence in thinking about tax administration in much the same way as the previous period led to convergence in tax policy advice. Today, most developing countries have not only rationalised their tax systems by replacing trade taxes by indirect taxes but have also invested in a standard set of reforms with a view to modernising their administrations. This is best illustrated in the establishment of semi-autonomous revenue authorities (SARAs), which can be defined as

tax administrations which operate with a degree of autonomy from their finance ministries. First established in Jamaica, the model has spread to Latin America, Africa, Asia and recently Greece. In line with NIE thinking, ring-fencing the administration from political interference supposedly signals a credible commitment to a less discretionary tax collection process, which in turn should boost compliance (Jenkins, 1994; Toma and Toma, 1992). However, the effect of SARAs is subject to debate.<sup>48</sup>

The creation of these new authorities coincided and sometimes facilitated the modernisation of specific tax administration processes and brought them into line with best practices from NPM. Reforms focused on increasing efficiency by reducing collection costs and increasing compliance by approaching taxpayers as customers. Fjeldstad and Moore (2008: 248) list examples of some of the key reforms:<sup>49</sup>

- Increasing the reliance on information technology.
- Introducing unique taxpayer identification numbers.
- Re-organising the collection system from one organised around different taxes, to one organised around individual taxpayers.
- Segmenting taxpayers by, for example, establishing large taxpayer offices.
- Separating back- and front-office functions to reduce the scope for bribery.
- Creating 'one-stop shops'.
- Simplifying procedures.

While the 'institutional turn' did bring governance issues back into tax reform, it is questionable whether it represented a return to the sort of institutionalism to which tax scholars such as Carl Shoup subscribed. He recognised that taxation and politics are closely intertwined with causality flowing in both directions.<sup>50</sup> This 'augmented' global tax reform agenda, however, assumed that once the 'right' institutions are put in place, the desired outcomes follow. Yet, in doing so it treats institutions as an exogenous technical problem and neglects their endogenous political nature. According to Bräutigam, Fjeldstad and Moore (2008: 3):

*'this lack of attention to the relationship between revenue raising and governance is surprising, especially given the long-standing linkage between taxation and governance assumed by students of European and American history.'*

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45 See Becker (1968).

46 See Tanzi and Zee (2000). Christians (2009) notes that in doing so experts have mainly targeted their efforts on the administration of VAT, as opposed to income taxation.

47 See Rodrik (2006) for a critical discussion of the 'Augmented' Washington Consensus.

48 See Therkildsen (2004), Kidd and Crandall (2006), Fjeldstad and Moore (2009), Von Haldenwang et al. (2014), Ahlerup et al. (2015) or Dom (2017).

49 While these nuts and bolts reforms have often been far-reaching and are likely important for tax administration, their impact on tax collection largely remains under-researched. An exception is the recent Ebeke, Mansour and Rota-Graziosi (2016) study which fails to find a significant connection between large taxpayer units and revenue performance.

50 See Brownlee, Ide and Fukagai (2013).

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It is precisely the apolitical nature of the global tax reform agenda which allowed it to spread across the world as rapidly as it did, but it is also its biggest limitation (Fjeldstad and Moore, 2008). By the late

2000s, the need for greater attention to specific local contexts and politics in particular was gaining broader acceptance.

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# 6 Post-2008: ‘fair’ tax systems and tailoring reforms to need

The global financial crisis once again raised questions about the role of the state and some of the instability that comes from unchecked liberalisation of trade and finance (Rodrik, 2011). Even the IMF, which historically championed the liberalisation of global capital markets, has questioned the pre-crash neoliberal consensus (Ostry, Loungani and Furceri, 2016).

Taxation has rarely been so prominent both in mainstream media and international development debates. Concerns over the fairness of taxation systems have been at the heart of arguments over how the gains from globalisation have been distributed. Issues of tax avoidance and evasion are on the front pages of newspapers and high on the agenda of development financing debates. Signatories to the Addis Tax Initiative have also committed to a doubling of aid to support domestic resource mobilisation.

## 6.1 Changing perspectives on development

If development policy debates in previous decades were characterised by grand narratives of development (‘getting the prices right’ or ‘good governance’), today there is significantly less confidence in overarching theories. The development economics profession has shifted away from macro questions of what drives development writ large and has attempted to come up with more empirically robust answers to smaller, more manageable questions. This ‘credibility revolution’ has seen significant improvements in the quality of research design in order to generate more robust empirical results (Angrist and Pischke, 2010). This has partly come about through the availability of more data and better data-processing technology. Moreover, advances in experimental methodologies are leading to a growing influence of randomised control trials (RCTs) within the discipline (Colander, 2005; Rodrik, 2015; Sandmo, 2011). Banerjee and Duflo’s *Poor Economics* (2011) brings together some of the insights generated from RCTs.

The financial crisis and its repercussions coupled with the emergence of China as a global power has also called

into question the dominance of ideas from the Global North as to what ‘effective institutions’ might look like. The idea that ‘West is best’ implicit in much thinking about how to promote social and economic development has come under much greater scrutiny. Authors have pointed to the success of countries like China and Vietnam to illustrate the development progress that can be made in the absence of institutional aspects set out in the ‘good governance’ agenda (Ang, 2016; Rodrik, 2003). There is also significantly less confidence in the ability of international actors to engineer institutional reform. This is partly the result of 20 years of significant investment with disappointing results, most vividly demonstrated in institutional building efforts that followed wars in Iraq and Afghanistan. Where international actors encourage superficial changes to the way institutions look but don’t improve the way they actually work, the result can be overloading governments, which undermines rather than supports building of state capability (Pritchett, Woolcock, and Andrews, 2013).

Rather than ‘good governance’, countries should aim for ‘good enough governance’ (Grindle, 2004) and institutions that are ‘best fit’ rather than ‘best practice’. A literature on ‘political settlements’ (see for example Mushtaq Khan, 1995) argues that efforts to replicate the institutions of liberal market democracies fail because they don’t take in to account the very logic of how states exert and maintain their authority in most developing countries. Using public funds for private benefit is not something that can be tackled with a new law or an anti-corruption bureau, because it is part of the fabric of the state. For this reason, governance reforms need to ‘go with the grain’ (Levy, 2014), and be ‘politically smart’ (Booth and Unsworth, 2014). International actors should broker dialogue that supports problem-driven iterative adaptation, rather than coming with ready-made solutions (Pritchett et al., 2013).

These ideas have led to a shift in the way in which the World Bank in particular looks at the issue of institutional development. Many of these ideas described above are summed up in the World Bank’s (2017) *World Development Report on Governance and Law*. A key message of the report was that reform efforts should



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focus less on institutional form (how systems look) and more on their function (how they work). It is not always as clear how this is translating into changes in development programming, but there has certainly been a much greater focus on questions of implementation (and not just best-practice ‘solutions’), illustrated in the rise of diagnostic tools such as the Public Expenditure Financial Accountability assessments.

## 6.2 Changing perspectives on the role of taxation in development

### 6.2.1 Renewed recognition that context matters

Many of these criticisms of the ‘good governance agenda’ have been replicated specifically on the debates on taxation. For instance, authors have argued that while administrative reform may be necessary, it is unlikely to be successful if political dynamics are not considered (Morrissey, 1995; Stewart, 2003). As long ago as 1918 Schumpeter suggested that the drivers of social, economic and political change could only be understood by appreciating how states had grappled with the challenges of raising and spending public funds (Schumpeter, 1918). While these ideas informed the thinking of the early institutionalists, they faded into the background in the period of structural adjustment and good governance. Contemporary interest in the links between taxation and state-building was revived in the 1980s with the work of, among others, Margaret Levi (1988). In her view, taxation depends not only on coercion by the state, but also on quasi-voluntary compliance. Taxpayers’ compliance is affected by the legitimacy of the state. Citizens in developed countries historically exchanged compliance for greater influence over the state, leading to patterns of accountability and ultimately democratisation (Tilly, 1992). Scholars including Mick Moore, Deborah Bräutigam, Odd-Helge Fjeldstad and Wilson Prichard have explored whether this idea about a ‘fiscal contract’ still holds for contemporary developing countries.<sup>51</sup>

Closely related to this is Bird and Bahl’s (2008) notion of ‘fiscal equilibrium’ as a way of thinking about reform. From this perspective the tax system (both its level and structure) reflects a consensus attained between conflicting interests: i.e. it is a fiscal contract between elites as well as between elites and society (Moore, 2004a). A reform is unlikely to be successful if it does not fit with the prevailing balance of power (Di John and Putzel, 2009; Khan, 1995). According to Bird (2013), the partial success of VAT can be explained because it coincided with the interest of elites, as they control most companies and would benefit from drawing into the tax net their informal competitors. The SARA reform, on the other hand, threatens the equilibrium since it explicitly reduces the discretionary power of the government and

the finance ministry in particular (Therkildsen, 2004; Von Soest, 2007). Similarly, Bird, Martinez-Vazquez and Torgler (2004) conclude that the lacklustre performance of Latin America’s tax reforms is not surprising given that the underlying political conditions did not change. A recognition of the two-way relationship between tax and politics is increasingly finding its way into mainstream work on development economics, most notably in the work of Besley and Persson (2013).

The move away from ‘one-size-fits-all’ theories towards a greater focus on building robust evidence for what works in specific contexts is also evident in the field of public finance. This literature once again recognises or at least poses the question whether context matters. This is in stark contrast with the supposedly global tax agenda seen since the 1980s, and is perhaps closer to what we observed immediately after the second world war. However, in contrast to the post-war period, where development economics was looking at the macroeconomic challenges of developing countries, this literature is rooted in a microeconomic framework. Great emphasis is placed on experiments and elaborate empirics in order to try to establish causality. These studies can broadly be separated into two streams:

- The first has focused on ‘structural’ administrative interventions. This research has also thrown up some counter-intuitive results. In certain contexts, switching from a profit to a turnover tax appears to increase revenue without reducing aggregate profits, despite the production inefficiency that it introduces (Best et al., 2015).
- The second strand extended previous work on compliance by taking up insights from the behavioural and nudging schools within economics. It looks at tax compliance from a psychological perspective.<sup>52</sup> Most compelling about this research is the large effect on individual behaviour of little nudges, such as making taxpayers aware of their audit risk, at least in high and middle-income countries (Hallsworth, 2014; Mascagni, 2017). Studies currently under way seem to be confirming these results in low-income countries, such as Rwanda (Mascagni, Nell and Monkam, 2017).

### 6.2.2 A greater focus on international taxation

Another major departure from previous periods has been a much greater focus on the role of international taxation. Stagnating incomes in the wake of the financial crisis spurred considerable interest in inequality and tax justice in the Global North. The Occupy Political Movement in the US claiming to represent ‘the 99%’ was indicative of concerns that globalisation has brought enormous benefits to the richest in society, while the incomes of the poorest and middle classes have

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<sup>51</sup> See Moore (2015) for a review.

<sup>52</sup> Luttmerr and Singhal (2014) review this literature.

stagnated. Taxation and in particular the perception that tax systems are unfair has been at the heart of these debates. Media coverage of the tax practice of large multinational corporations and the use of offshore tax havens by wealthy individuals and firms documented in leaks like the ‘Panama Papers’ have contributed to this significant shift in public opinion.<sup>53</sup>

This, in turn, has greatly increased the policy and academic salience of the role of international taxation: research into tax competition and tax avoidance by multinationals has boomed in recent years.<sup>54</sup> The problem of taxing capital in a globalised world runs throughout this literature. While some forms of tax competition are desirable, Keen and Konrad (2013) conclude that the big problem is that it is difficult to distinguish between these and more harmful types of tax competition. One of the consequences is profit shifting,<sup>55</sup> which is leading to severe erosion of the taxable base, especially for developing countries where administrative capacities are low and reliance on corporate income tax is high (Crivelli, De Mooij and Keen, 2016; UNCTAD, 2015). Much of the academic work is focused on identifying the extent of this profit shifting and the associated tax revenue loss (e.g. Johannesen, Tørsløv and Wier, 2017).

Questions of international tax governance and standards and how they might affect the capacity of developing countries to tax have also been at the heart of development finance debates. At the third Financing for Development Conference in Addis Ababa, a joint commitment was made ‘to enhance cooperation to combat tax evasion, fight corruption, tackle illicit finance, and promote good financial governance, transparency and accountability’ (Addis Tax Initiative, 2015). The extent of revenues that governments in low-income countries may be losing out on as a result of tax avoidance and tax evasion continues to be the subject of considerable contention (Forstater, 2015).

### 6.3 International engagement/advice on taxation in developing countries

Developments in international tax advice have evolved both in line with the changing perspectives on taxation and with the call for more context-specific reforms. With respect to the latter, the literature on the political economy of taxation has featured prominently in donor documents. Optimism about the potential role that taxation can play in state-building has for example

been incorporated in some of the policy literature (e.g. OECD, 2010). However, it has seemingly not had a dramatic effect on the programming of aid for taxation. The default advice still is policy neutrality with credible institutional underpinnings. Broad-based consumption taxes, in particular VAT, and segmentation of taxpayers are still very much at the core of the agenda.

That said, there does seem to be significantly more tolerance for tailoring reforms to specific context than there was 20-30 years ago. While economic efficiency is still paramount, some distortion in the name of simplicity or equity is tolerated. For instance, a recent IMF policy paper (2017: 22) on building fiscal capacity in fragile states suggests: ‘Where a simple tax is believed to be generally distortionary, its cost may be minor relative to the potential benefits of state-building and ending fragility.’ In certain circumstances, these second-best options, such as customs tariffs and turnover taxes, are no longer the taboo they once were. In keeping with the development economics literature, international organisations are making greater use of experiments and behavioural interventions to assess the merits of these second-best options. Experiments of the kind undertaken by the UK tax authority looking at how different reminders or ‘nudges’ to pay taxes have since been repeated in several developing and emerging economies.<sup>56</sup> Other countries like Tanzania and Pakistan have acted on these findings and have put in place incentives for accelerated VAT refunds for taxpayers with a good compliance history to encourage compliance (Fox and Murray, 2014).

Similarly, efforts to support improvements to tax administration have become more nuanced. Big-ticket reforms such as the introduction of semi-autonomous revenue authorities have lost some of their appeal. New diagnostic tools, in particular the Tax Administration Diagnostic Assessment Tool (TADAT), are being used to help to identify reform priorities.<sup>57</sup> However, while this allows different sequencing of reform measures and perhaps greater realism in terms of the expectations, it is still not clear whether TADAT will incorporate the lessons learned from the introduction of the Public Expenditure and Financial Accountability (PEFA) indicators. Moreover, there still very much seems to be a ‘right way’ to go about taxation. Countries can choose which items to pick from the menu first, but the menu itself is fixed.

The greater international focus on equity and international taxation has also had an influence on the

53 The ‘Panama Papers’ refer to 11.5 million leaked documents that detail financial and attorney–client information for offshore entities belonging to the Panamanian law firm and corporate service provider Mossack Fonseca (Obermayer et al., 2016).

54 See Genschel and Schwarz (2011) for an early review.

55 Multinationals lower their global tax bill by shifting their earnings from subsidiaries facing higher taxation to those in low-tax environments.

56 See Castro and Scartascini (2014) on Argentina, Ortega and Scartascini (2015) on Colombia, Brockmeyer et al. (2016) on Costa Rica, Kettle et al. (2016) on Guatemala, Hernandez et al. (2017) on Poland or Mascagni, Nell and Monkam (2017) on Rwanda.

57 TADAT assesses nine core administrative functions, much like PEFA did for expenditure management. This forensic approach should allow reforms to be tailored to the needs of specific countries (Morrissey, 2015).

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nature of donor-financed reform initiatives in developing countries. The OECD's Base Erosion and Profit Shifting project aims to address some of the global governance challenges in taxing multinational enterprises. This initiative has received strong political backing from the G20 group of countries. There are concerns, however, that the key issue of how to allocate the income of multinational enterprises (MNEs) according to their activities and the value added in each country remains unresolved (Picciotto, 2017). Specific initiatives are, nevertheless, being developed aimed at strengthening the capacity of governments of developing countries to address some of the challenges posed by tax avoidance. For instance, the OECD and UN have supported a *Tax Inspectors Without Borders* project aimed at addressing tax avoidance by multinationals (OECD and UNDP, 2017). A platform for international collaboration tax

has also been set up that comprises the IMF, OECD, United Nations and World Bank. Recent initiatives include the development of 'toolkits' aimed at supporting developing countries with specific challenges related to international taxation.<sup>58</sup>

There is, however, some debate as to whether the level of focus on international taxation is commensurate with the returns relative to taxing the domestic population. Only a proportion of corporate taxation is affected by the types of harmful tax practices that the OECD Base Erosion and Profit Shifting project aims to address. Given the capacities of finance ministries in many developing countries, there is a risk that the preoccupation with questions of international taxation could crowd out the attention government officials need to pay to strengthening the collection of other key sources of tax revenue.

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<sup>58</sup> For instance, a toolkit is under consultation looking at the taxation of offshore indirect transfers of assets.

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# 7 What can be learnt from the past?

The preceding discussion has provided a brief overview of key developments in efforts to reform tax systems over the past century. It has described how ideas on the role of taxation in development have evolved alongside wider shifts in our understanding about the drivers of social and economic development, as well as changing perspectives on taxation, originating mostly in the United States and Europe.

One particular observation stands out: the development of ideas about taxation has not necessarily been linear. Instead, there appears to be an element of cyclicity to it. This is particularly true at the ‘macro level’, where for instance questions about the respective roles of the state and market have oscillated in response to economic crises. In the early 20th century, the dominant thinking around economics was *laissez-faire*, but the Great Depression and the second world war saw a more activist role for the state. The oil crisis of the 1970s saw the state retreat, while the financial crisis of 2007–08 has once again raised questions about the role of the state in economic management. Similarly, ideas about the role of international advisers in supporting taxation reform also seem to be returning towards some of the ideas common in the period immediately following the second world war. There is a growing view that advisers should not simply present a fixed set of best-practice reforms, but rather consideration needs to be given to specific political and institutional settings. This is very much in keeping with the approach of the institutionalist school looking at questions of taxation in the mid-20th century.

However, the ultimate target of international tax reform – to raise the amounts of tax collected in developing countries – has remained somewhat elusive in the last 30–40 years. While there have been certain individual successes, the average across has continued to fall short of the targets the international community has set for developing countries.

What lessons can then be learnt about past mistakes that should not be repeated? Given the differences in advice observed across time, what ideas can advisers be confident of – and where should they be a little humbler in presenting ‘silver bullet’ solutions?

**Lesson 1: There has been and continues to be a strong influence of ideas from the Global North on reforming tax systems that may not necessarily be appropriate to needs for developing countries.**

A review of the past century of efforts to reform tax systems demonstrates the strong influence of ideas from the Global North. Advice on tax system reform has been more closely linked to the salience of political issues in developed economies than the specific challenges of developing countries.

This continues to be the case today. Much of the contemporary focus on tax stems from donors looking for alternative sources of financing for their priorities in a world of flat aid. Donor interventions are not necessarily framed as supporting the development of better tax systems, but as a means to mobilise resources for specific kinds of spending. More tax is sometimes depicted to be in and of itself a good thing, irrespective of the costs that might be incurring on the economy. It has also been suggested that the current focus on international tax issues might reflect their salience in development financing debates, but distract government from potentially larger sources of revenue gains from more prosaic domestic reforms (Forstater, 2018).

This globalisation of ideas on reforming tax systems runs counter to the findings of the scholarly literature on institutional reforms in developing countries that consistently points to the importance of being context specific. Indeed, much of the contemporary discourse on strengthening tax systems explicitly recognises that reform efforts should be ‘country-owned’ and not driven by the interests of donors. The Global Platform for Collaboration on Tax (2016: 4), for example, has called for ‘the development of country-owned medium-term revenue strategies, or tax reform plans depending on country circumstances’.

The irony in this call for ‘country ownership’ is that the approach taken to arrive at that objective very much reflects ideas drawn from a certain conception of how bureaucracies should work and approach reform. A top-down, holistic, medium-term strategy is potentially a very effective mechanism for coordinating actors around a coherent plan in countries with well-functioning, impersonal hierarchical bureaucracies. The

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problem is that most of the countries where revenue collected has barely shifted over the past 50 years may not necessarily have such conditions in place. Authors such as Brian Levy (2015: 245) have questioned whether comprehensive reforms are likely to be the most effective strategy for reform in more ‘personalised’ political settings where there is lack of consistent leadership with longer-term orientation. He argues that in ‘such settings, a preoccupation with comprehensive public management reform initiatives has a high risk of being counterproductive – distracting attention from more achievable goals, only to be abandoned before anything has actually been achieved.’ Caution should be taken in uncritically replicating the approach to reform, as well as the content.

## **Lesson 2: More could be done to help advisers and governments distinguish between the ‘custom-built’ and the ‘bad idea’.**

The history of tax reform shows us a push to global ideas, while the scholarly evidence on institutional reform consistently points to the need to be ‘context specific’. Richard Bird (2013) suggests that the future of advice on tax policy is for systems to be ‘custom-built’. Taken to its extreme, however, there is a risk that we do not learn the lessons of failed reforms and ‘bad ideas’ elsewhere.

Distinguishing between ‘custom-built’ and patently ‘bad ideas’ is not straightforward for an adviser working in a particular country. Experimentation is increasingly championed in and of itself as a good thing, but can also be potentially wasteful if countries are engaging in experiments that have a long and wide track-record of failure. How can an adviser or recipient government distinguish between the received wisdom of ‘good practice’ underpinned by strong theoretical and empirical evidence across different contexts and that arising from tacit knowledge of ‘what works well’? How can that knowledge be applied more critically?

A number of things can be done:

1. More work could be done to contextualise empirical work on tax reforms. While the recent credibility revolution in economics has been instrumental in understanding *what* works in very narrowly defined settings, it has been less useful when it comes to the question of *why* things work. The latter requires a detailed investigation of the political, institutional and historical realities of the reform space. The political economy literature on tax, on the other hand, raises questions over the longer-term links between taxation and society. It feels as though there is perhaps something missing in the middle in the current

tax research agenda, and that is research aimed at understanding how different contextual factors (political, economic, institutional, etc.) interact with specific policy and administrative reforms.

2. Related to this, there would be benefit in better understanding particular outliers. Do certain low-income countries have tax systems that seem to be performing effectively (or poorly) relative to their peers, and what explains those differences? Understanding within-country difference in performance may also provide useful insights: why are certain tax offices out-performing others relative to expectations?
3. Another way that donor countries could support a more critical appreciation of ‘good practices’ is to commit to diagnostic assessments of their own tax systems. If benchmarking is here to stay, it would be useful to understand, for instance, whether there are certain measures in the tax administration diagnostic assessment that OECD countries score well on across the board and others where there is significantly more variation.
4. At the country level, donors can do more to help countries identify and analyse their own problems through building the quality of information, the processes and the tools to collect, use and analyse that information. These are unlikely to be the glamorous quick-win reforms that deliver highly visible payoffs in the short term, but they are the foundations on which everything else is built.

## **Lesson 3: International technical assistance needs to be designed in a way that allows for ‘custom-built’, long-term approaches to support sustainable and effective tax reform.**

Finally, looking back over the past 50 years at the changes in amounts of revenues collected shows that strengthening tax systems in developing countries is very difficult. The history of tax reform has shown us that big-ticket reforms have seldom delivered sustained increases in tax levels unless they had an adequate degree of continued political support.

This then calls for some humility for international actors working on tax reform. For tax advisers, this implies a shift from quick wins to playing the long game, remaining engaged until there is a domestic coalition for tax reform.<sup>59</sup> This, though, requires working politically and paying more than lip service to national ownership. It requires flexibility to learn and change tack if needed. It means working through options with governments rather than presenting prescriptive reform road-maps.

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<sup>59</sup> Among the conditions which made the 30-year relationship between Indonesia and the Harvard Institute for International Development successful, particularly for tax reform, were a long-term commitment and national ownership as the initiative was self-funded by the government of Indonesia (Stern, 2000).

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It also requires a significant amount of patience and perseverance as well as a thorough understanding of local contexts.

It is unclear that the current international architecture for providing support to taxation lends itself well to a long-term patient approach. There is a pressure on donors to be able to demonstrate results for the funds they are providing to strengthen tax systems, typically within short project cycles at home. Experimentation with custom-built solutions is bound to result in some bad ideas and failures, but these might be the price to pay for learning what works well within a particular country. And although the recently introduced medium-term revenue strategies extend the time horizon, it remains to be seen whether they will genuinely be locally owned and will not end up pushing the same set

of reforms across different countries. For the technical adviser it is therefore essential to ‘play the right game’: recognising that the debate is less about the technicalities of taxation and more about what the people who matter want (Bird, 2013). At times, there might be a trade-off between what is economically desirable and what is politically feasible.

The Addis Ababa commitments have the potential to make a real and lasting contribution to strengthening tax systems in developing countries. But simply doubling the money for the same pre-packaged solutions is unlikely to yield the expected benefits. If international organisations can find ways to lend support to patient, long-term experimentation, there may be more marked improvements in tax performance in the coming century.

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