Tax for development: why better public services matter

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“Stop corruption! We want security, health care and education”. This was the bold demand of a Brazilian protester in the football stadium of Maracanã, last summer. In Brazil, as in most emerging economies where protests took place a year ago, citizens did not ask for lower taxes but for better public services.

Most of the protesters belonged to the so-called fragile “middle-class”, neither poor nor rich; their political involvement had been rare so far. This represents a significant socio-political change, especially as Brazil’s tax collection is one of the highest among emerging economies (36.3% GDP in 2012, vs. 20.5% in Latin America) and even higher than the OECD average (34.6%).

Would you be willing to pay higher taxes if you think public services are good? Would you be less likely to justify tax evasion if you had recently witnessed good practices in the tax administration? Would you support a tax increase if you think that hard work is the main determinant of success in your country? All of these questions are taking a central role in the debate on taxes and development, and this is good news.

Citizens are more willing to bear taxes, especially in times of crisis, if they think the effort is shared fairly and do not see other citizens and big companies being allowed to avoid them. This may sound obvious, but not so long ago the debate on taxation and development seemed to be just a matter of enforcement. This new view justifies the efforts focused on strengthening not only tax administration, but transparency as well. The OECD work on Base Erosion and Profit Sharing, to fight evasion from multinationals, which emerged from the G20 determination to modernise the tax systems on a multilateral basis, had a great impact in this regard.

These initiatives on tax administration could be even more powerful if accompanied by better “administration of taxes”, that is, improvement in how governments spend these taxes. The empirical evidence all over the world shows that corruption, especially within the tax administration, affects citizens’ willingness to pay taxes. Among African countries, those where tax officials are considered corrupt (around 30% in Benin or Mali) are also those where the fewest people believe in the legitimacy of the tax department to enforce tax payment. In Asian countries, the share of the population willing to pay more taxes in exchange for more services increases if there is trust in the central government, as is the case in Bhutan or the Maldives. In Latin America, despite a pessimistic starting point where the share of the population that finds tax evasion unjustifiable is far from a majority (34%, vs. 62% in OECD countries), those citizens who are satisfied with the public services they can get – notably on education and health – do not accept tax evasion and think that the tax level is not too high.

Taxes are a measure of state capacity. Public provision of high-quality goods and services and a transparent and progressive tax system are signals of a healthy social contract. Therefore, both go hand in hand: if health care, education and infrastructure are scarce, regressive or of low-quality, the social contract weakens. But if citizens believe that taxes and expenditure are efficient and fair, the legitimacy of democracy itself gets stronger.
Taxpayers are becoming more and more active as customers of public services, rather than passive citizens. In this regard, governments should not only monitor and enforce, but also deliver. Satisfying their democratic demands is urgent, both in developed and emerging economies. Tax reforms, designed so often on paper and even tested in practice, are hindered if public expenditure is seen as illegitimate. Technical work on the tax administration and tax design sides should be complemented with efforts to strengthen the fiscal legitimacy by improving public services and government efficiency. This means designing an effective fiscal policy capable of addressing the challenges of development because, at the end of the day, taxes are a matter of trust.