Political settlements and revenue bargains in Africa: New policy priorities?

Anne Mette Kjær

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Brief project summary

Over the last decade, a number of governments in Sub-Saharan Africa have become less dependent on aid from their traditional partners. They increasingly rely on other revenue sources such as VAT and income taxes, income from natural resources, and financial loans from non-traditional donors such as China or from the international private capital market. At the same time, the policy priorities of these countries' governments appear to be changing as they become less dependent and re-claim ownership. Whereas poverty reduction and social service provision were highly prioritized around the turn of the Millennium, focus now appears to have shifted towards infrastructure, power supply, and industrial policy. Declining aid dependence and more country ownership over policy are clearly desirable. However, we know little about how the changes in the composition of revenue providers affect bargaining over revenue and ultimately, public policy. Revenue bargaining processes are inherently political. They are affected by the countries' political settlements and electoral pressures. This proposed research program explores how formal and informal revenue bargains affect public policies. We offer a contextual political settlement analysis in order to better understand the politically mediated influence of the main revenue providers. We do this by combining a macro-historical comparative study of Uganda and Tanzania over time with a micro-level study of specific instances of revenue bargaining. Uganda and Tanzania are typical examples of the changing composition of revenue providers that African governments experience and yet, despite many similarities, their political settlements differ substantially in terms of the number of and degree of conflict between powerful factions. They therefore make for good cases of comparison.

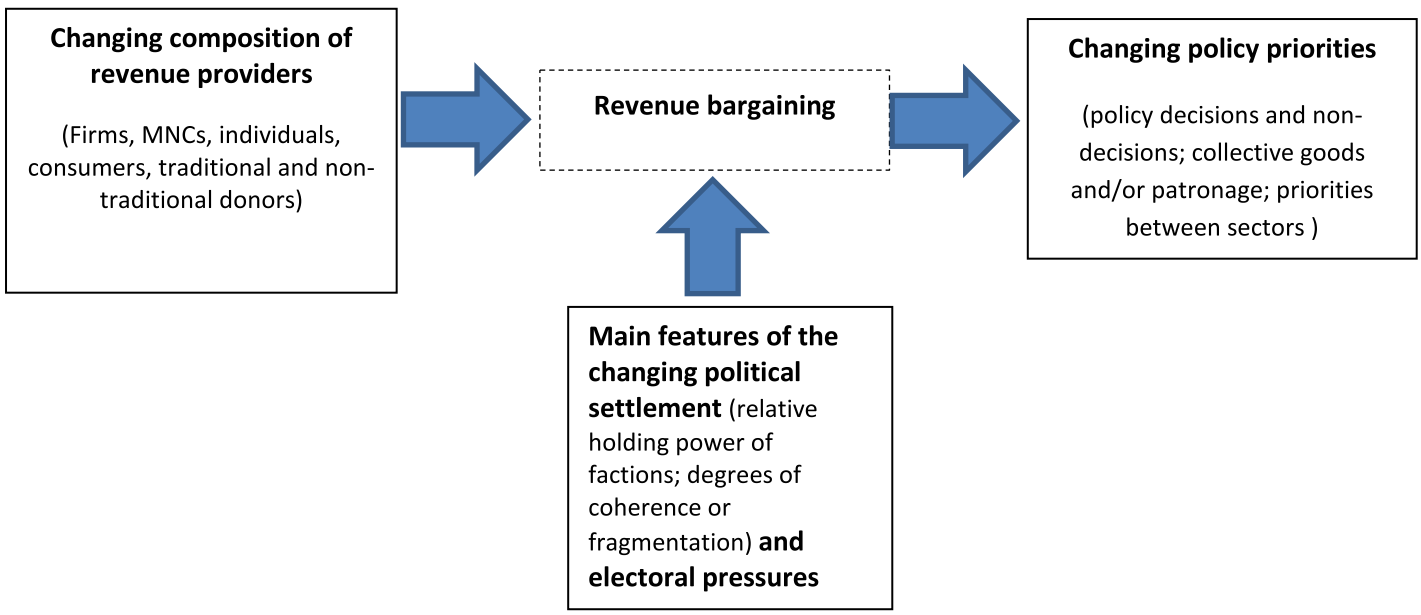
State of the art and objectives

Sustained economic growth over the last two decades has increased domestic revenue collection in many sub-Saharan African countries. Even if absolute flows of Overseas Development Assistance (ODA) have continued to grow, aid now takes up a smaller proportion of GDP relative to domestic revenues and revenues from Foreign Direct Investments (OECD, 2014) . Uganda and Tanzania are representative of these so-called emerging economies (Radelet, 2010). Whereas net ODA constituted as much as half of their national budgets two decades ago, it now takes up less than twenty percent (Kjær and Ulriksen, 2014). Income taxes and Value Added Tax, as well as corporate taxes constitute significant and increasing proportions of the domestically collected revenue (Keen and Mansour, 2010; Kangave and Katusiimeh, 2014). In addition, non OECD DAC donors, such as China, are becoming more important, and revenues from oil and natural gas findings will potentially make both countries independent of aid. The similar trends in revenue composition but different political set-ups in Uganda and Tanzania make them good cases for pursuing our **overall objective,** which is to explore the implications of the changing composition and power of revenue providers for the countries' policy priorities. Our main research question is: In a context of changing composition and relative power of revenue providers, how do revenue bargaining processes evolve and government policy priorities change? We want to understand who the main contributors to government revenue are, and what they want in return. We want to understand better how that 'return' materializes and is reflected in formal and informal government priorities.

Policy *priorities* refer broadly to both the actual formal and informal decisions but also the non-decisions taken by a government. A policy has been prioritized if there has been a sustained effort to implement it and funds have been allocated (Kjær and Therkildsen, 2013). Policy decisions may materialize as patronage for specific groups and they may benefit the broader populace in the form of collective goods (Booth, 2013). Policy decisions can also be non-decisions. For example, since the agricultural sector is characterized by low productivity it is hardly taxed at all in most African countries and therefore it is not prioritized by the ruling elites who have often failed to implement agricultural policies effectively (Therkildsen, 2012). In other words, government policies are likely to benefit the sectors and actors from where they get revenue.

A 'revenue bargain' refers to a "wide range of types of (political) exchange, ranging from explicit haggling ('If you do this, I will do that') to indirect, strategic, anticipatory interaction ('Let us announce more public spending on health now, in the hope that Parliament will be ready to accept an increase in VAT rates next year')" Moore (2008: 37-38). A revenue bargain is an explicit or implicit, formal or informal agreement reached between the contributors of government revenue (i.e. firms, individual taxpayers, consumers, aid donors) and the government about what to contribute and what to get in return. The bargain may materialize as a 'fiscal contract' between a government and tax payers (Levi, 1988; Ali, Fjeldstad, and Sjursen, 2014). Revenue bargains also appear around elections, because competitive elections provide an incentive to lower general tax collection while at the same time promise services to broad publics (Prichard, 2014). This happened, for example, when the Ugandan president abolished the personal graduated tax prior to the 2006 elections and increased spending on secondary education (Kjær and Therkildsen, 2013). The cost of running elections may also induce ruling elites to grant tax exemptions to powerful groups who fund the ruling party, a bargain that will result in reduced revenue to state (Therkildsen, 2013). Revenue bargains are thus inherently political, and their policy outcome depends on the nature of a country's political settlement.

Figure 1: Theoretical model



We are not well equipped theoretically to understand the politics and hence implications of revenue bargains, and this projects theoretical contribution will be to develop a framework to understand these processes better, We combine insights from 'fiscal contract theory' and 'political settlement' theory to develop a theoretical model, depicted in Figure 1. 'Fiscal contract theory' is based on an assumption that since tax collection is costly and requires significant bureaucratic effort, ruling elites have incentives to reduce the cost of tax compliance by providing credible commitments to tax payers, for example by giving them a say over policy or by providing them directly with benefits (Levi, 1988; Tilly, 1992; Timmons, 2005). According to this logic, a broadening of income taxation would then lead to revenue bargains entailing universally beneficial policy outcomes such as national economic development and poverty reduction (Moore, 2008). Such broad-based bargains usually happen through the regular occurrence of elections whereby tax-payers can punish ruling elites if they do not stick to their part of the bargain. Research on the so-called natural resource curse follows the same logic when pointing to the *lack* of broad-based bargaining when single large firms are the main income source. A high abundance of natural resources tends to make ruling elites *less* inclined to promote national economic and social welfare, because they have no incentive to bargain with citizens (Ross, 2004; Moore, 1998; Atkinson and Hamilton, 2003). Development aid has been argued to have similar effects, because it tends to make ruling elites accountable to their main aid donors rather than to their own populations (Moore, 1998; Brautigam, 2000).

The benefits of these contributions notwithstanding, they are based on rather general assumptions about the effects of the source of revenue, and they tend to lack country level nuance (Rosser, 2006). It is arguably *the way* in which the resource rents are managed rather than the rents in themselves that creates problems for resource-rich countries (Buur, Therkildsen, Hansen, and Kjær, 2013: 15; UNCTAD, 2013). Similarly, the lack of broad income taxation may not automatically preclude civil society influence on policy-making, nor does the presence of development aid in itself lead to less income tax collection or fewer domestic bargains (Morrisey, 2014; Hassan and Prichard, 2014). The point here is, we argue, that the effects of different sources of revenues on development are country-specific; they are *politically* mediated and this project develops tools to incorporate such politics into the analysis.

Political settlement theory brings our attention to the politics that connect economic structures and institutions with policy outcomes. A political settlement is a combination of power and institutions that is mutually compatible and also sustainable in terms of economic and political viability (Khan, 2010). In economies based primarily on subsistence agriculture, large informal sectors, and very small national budgets, there is a struggle for scarce resources, and political stability is only achieved by appeasing powerful factions through patronage (Khan, 2010; Whitfield, Therkildsen, Buur, and Kjær, 2015). In clientelist political settlements, conflicts are solved by using public resources to give powerful groups access to create and allocate rents, such as government contracts, land rights, monopolies on business activities or tax exemptions (North, Wallis, and Weingast, 2009; Therkildsen, 2012). The holding power of these groups refers to their ability to impose their interests on other groups or the state (Khan, 2010). Holding power is partly based on income and wealth but also on historically rooted capacities of different groups to organize. The country-specific differences in the distribution of power, rather than forms of political regime, are the source of variation among political settlements and these differences help to explain variations in policy outcomes. Hence, the political settlement approach helps to discern important differences in the organization and distribution of power that is not captured by the broad label of semi-authoritarian regime used by democratization-theorists.

Political settlements in developing countries undergo continuous change. The introduction of regular competitive elections tends to increase political costs: running election campaigns and holding the coalition together is expensive (Lindberg and Morrison, 2008; Therkildsen, 2012). Moreover, elections tend to strengthen the holding power of lower level factions of the ruling coalition, such as local party chairmen, because they can mobilize votes (Whitfield, Therkildsen, Buur, and Kjær, 2015). Domestic and foreign capitalists, and others with money, become important sources of political financing, especially in countries such as Uganda and Tanzania, where the most important revenue providers are a few hundred capitalist firms (Therkildsen, 2012). Also, political settlements may change as the composition of revenue changes. Oil revenue, for example, may serve to consolidate the ruling elites in power because they get more funding to use as patronage to hold the coalition together. Causal relations are thus complex, and in Figure 1 we have simplified for the sake of analytical clarity.

In order to analyze the revenue bargaining process, we need to understand the relative holding power of revenue providers in the country-specific political settlement and the degree of fragmentation or coherence of the ruling coalition. Fragmentation in the ruling coalition and competition between factions will tend to make the ruling elite use policy as patronage to keep the most powerful factions within the coalition. This is not as necessary if the ruling coalition is coherent. Finally we need to understand the way in which elections alter the holding power of different groups and thereby the revenue bargains that take place and lead to specific policy priorities. Our main hypothesis is **that changes in the relative power of revenue providers will lead to a change in policy priorities of national governments.** He who pays the piper calls the tune' is not only an old saying, but as we have indicated, an assumption that has influenced fiscal contract theory. Providers of government revenue will want to influence policies. Given the nature of different types of revenue, it varies how different fund providers influence policy. With respect to taxation, taxpayers are not uniform (Timmons, 2005). Our more specific sub-hypotheses are that

- The extent to which revenue providers influences government policy will depend on their relative holding power
- The relative holding power of revenue providers will depend on their organizational capabilities, the size of their contributions in terms of revenue or party-funding, or their importance as electoral constituencies.
- The ruling elite will tend to favor powerful revenue providers whereas the more disorganized consumers and small-scale producers are likely to be less powerful with regard to policy-impact.

Methodology

We combine an understanding of the macro-level political settlement with micro-level instances of revenue bargaining (Hassan and Prichard, 2013).

The <u>macro-historical approach</u> focuses on the key features of the political settlements and how they affect political bargains around revenue and development policy in Uganda and Tanzania over time. The purpose is to identify changing policy priorities since the early 1990s when elections were gradually institutionalized and the economies slowly started to grow leading to incremental changes of the revenue base. We follow a comparative logic in that Uganda and Tanzania share key characteristics in economic development and declining aid dependence, but differ with regard to important features of the political settlements. Particularly, the degrees of fragmentation of the ruling coalition differ (Whitfield, Therkildsen, Buur, and Kjær, 2015). Uganda's political factions have an ethno-regional character that is lacking in Tanzania and this tends to attenuate fragmentation in Uganda. The dominant party in Tanzania, CCM, has institutionalized succession in the party leadership, whereas power in Uganda is more personalized, in that there are no presidential term limits. Consequently, the patronage systems depend on the president as a person which may compromise attempts to build institutional capacity in order to deliver on policy promises. Military factions of the ruling coalition in Uganda are very strong and maintaining political stability means appeasing these factions to an extent not seen in Tanzania. These differences influence the relative holding power of revenue providers and hence the politics of revenue bargaining.

First, we will uncover changes in policy priorities over time in several ways: (1) analyses of major changes in budget allocations based on national budgets and budget speeches; (2) analyses of major changes in prioritized sector policies; (3) expert surveys in each country built on at least 20 country experts (such as academics, policy makers, business people, civil society associations, and donors) to identify major changes in policy priorities in the sense that ruling elites not only decided them but also allocated funds and pushed for their implementation. Such a survey will also help us uncover which interests and voices had an impact on policy priorities and how they are linked to the ruling coalition; and (4).analyses of spending and taxing priorities in national and presidential election campaigns as portrayed in the media, in speeches and in local academics analyses.

Second, we study the composition of revenues over time, the institutional set-up of tax collection, tax bargaining and tax reforms over time, as well as the position of the main revenue providers vis-à-vis the ruling coalition through a combination of literature reviews, in depth expert interviews; parliamentary debates (reviewing the Hansards) and in the English language newspapers (which both countries have). We also use available statistics, analyses and revenue analyses produced by the revenue authorities, the National Development Plans, the Oil and Gas Policy, the State of the Nation Addresses, Local Government Finance Committee Reports, Tax Statutes and, where possible, by obtaining contractual documents between government and investors such as production sharing agreements and power purchasing agreements.

These two types of analyses combined – and together with the secondary literature – will enable us to uncover the revenue-bargaining-policy nexus over time and compare them across the two countries.

We will conduct a number of micro-level studies to explore in more detail how revenue providers may influence policymakers. Their specific purpose is to identify the interests of specific revenue providers and to uncover the extent to which these interests are reflected in changing policy priorities. We will select the case-studies on the basis of variation of types of contributor (e.g. formal sector employees as income tax payers, consumers as VAT payers, natural resource extractive companies, donors etc.) to uncover a varied set of bargaining processes. These deep case narratives of specific instances of bargaining over tax, fees and other revenue sources will enable us to study further the implications of our macro-level findings. They help us discern patterns of variation within and between countries in that we can study different revenue providers within the same country political settlement; and we can compare the same type of revenue providers across the two countries' political settlements.

For each case study, we will analyze the revenue bargaining process in a step-wise process: first, we analyze the interest and holding power of the revenue provider. Second, we analyze how and in what ways the revenue provider may be important to the ruling coalition. Third, having established the relative strength and interests of revenue provider and the ruling coalitions, we explore what goods (collective, or individual) the provider might get in return for the revenue payments. This leads to the fourth and final step, which is to assess the formal or informal policy priorities that follow from this bargaining process. Taking the point of departure in public debates and in interviews with key informants, we will identify interview-respondents who are knowledgeable about specific cases, and from them use the snowballing technique to further identify informants who can help uncover the interests of the revenue providers; how they sought to realize them, how other actors potentially thought to influence; how the process of bargaining with the ruling elites / the authorities came about and how their interests did or did not have an imprint on their policy priorities.

The type of qualitative research requires access to informants and documents that are not always easily accessible. However, the team is in a good position to access data and information since all involved researchers have long term experience and well established networks in Uganda and Tanzania not just in general, but with particular regard to research on taxation and political economy, as indicated below.

Relevance

Strengthening domestic resource mobilization is high on the policy agenda in Uganda and Tanzania and at the same time, the ruling elites struggle to maintain political legitimacy in a context of regular elections and popular pressure for democracy (GoU, 2011; URT, 2010). Walking the fine line between increasing domestic revenue and deliver on election pledges by allocating more money for purposes of national development is difficult for the governments. This research is highly relevant for Ugandas and Tanzanias political agendas and offers to provide knowledge that can feed into these national conversations between governments, citizens, revenue providers, and civil society organizations demanding more transparency in the use of revenues. At the same time, many aid donors want to support a strengthening of the domestic resource base, but they also have to find a way to navigate and to give meaningful aid in a process where they lose influence on the recipient government's policies. Our research will be able to offer policy relevant advice to donors too, and it speaks directly to Denmark's Development strategy which states that '[m]any developing countries are prospering and are less dependent on traditional development cooperation. This gives rise to new opportunities for cooperation, trade and investments' (DG, 2012: 5). In order to understand these opportunities, knowledge about the politics of revenue bargaining and policy priorities is very useful.

Expected outcomes and outputs

An important outcome will be strengthened research capacity (see the heading so named below). The main academic outcome of our research project will be new knowledge about the political economy drivers of public policies in countries with declining aid dependence. We will disseminate these results widely in the scientific community through the specific outputs of four Ph.D. theses, at least 10 peer-reviewed journal articles and book chapters, one co-authored book, 3 conference panels, and inclusion of international advisors and colleagues in our won international conference to take place in Denmark. Our policy-relevant outputs will be inclusion of national dialogue groups in national dissemination meetings in connection with our annual workshops; we will have 2 policy seminars where key policy stakeholders from media, civil society and government are invited. At these seminars, research is presented in the form of at least one policy report at each workshop in a popularly accessible way. Except for the Ph.D. dissertations; publications will be co-authored. We will organize regular write-shops. 12 working papers, 4 policy briefs,