Building support for taxation in developing countries: Experimental evidence from Mexico

Gustavo A. Flores-Macías

Department of Government, Cornell University and Cornell Institute for Public Affairs, USA

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Abstract

Drawing on insights from the literature on institutional design—how rules shape behavior to achieve desired outcomes—this article examines how certain design features of taxes—such as allowing for civil society oversight, earmark mechanisms that direct tax revenue for a specific purpose, and sunset provisions that make the duration of taxes finite—affect political support for tax reforms. It also evaluates how three important aspects of the fiscal exchange—trust in government, perceptions of the public good, and level of income—shape the effect of these design features. Based on an original survey experiment focusing on the provision of public safety in Mexico, I find that these design features increase political support for taxation, especially among those with low trust in government and low income. These findings have important implications not just for Mexico but also a number of other countries across Latin America that have both low levels of extraction and increased public spending imperatives.

1. Introduction

Taxation lies at the core of several prominent bodies of literature in the social sciences, including those on state capacity, government accountability, economic reforms, and development. From their insights we know that taxation is a fundamental source of resources that can translate into state strength (Brautigam, Fjeldstad, & Moore, 2008; Schneider, 2012), that taxation results in a link of accountability between citizens and rulers that makes governments more responsive (Prichard, 2015; Tilly, 2009); that it is conducive to addressing inequality (Ferranti, David, Ferreira, & Walton, 2004; Mahon, 2012; Scheve & Stasavage, 2010) and promoting growth (Bird, 2012), and that, for these reasons, taxation is an essential tool for development (Huber, 2009; Inter-American Development Bank, 2013). Not surprisingly, calls by think tanks (Council of Foreign Relations, 2014) and international organizations (CAF Banco de Desarrollo de América Latina, 2012; Inter-American Development Bank, 2013) for increasing fiscal extraction in the developing world have gained momentum in recent years.

Yet, despite the academic literature and the policy world endorsing taxation, taxes remain perennially loathed by the publics that are responsible for bearing those burdens. Indeed, as the Panama Papers suggest, individuals will go to great lengths to avoid tax obligations—often setting up dozens of offshore corpor-
In studying the relationship between design features and political support for increased taxation, this research makes three main contributions. First, it advances our understanding of the ways in which policymakers can ameliorate opposition to economic reforms. The literature on the politics of taxation in developing countries has paid considerable attention to factors that are often beyond policy makers' control, such as crises—including economic downturns (Bird, 1992; Sánchez, 2006), hyperinflation (Mahon, 2004), banking system failure (Hallerberg & Scartascini, 2015), and natural disasters (Fairfield, 2015, 265)—as well as a number of more structural factors affecting governments' ability to tax, including regime type (Cheibub, 1998); the economy's degree of openness and sectoral configuration (Bahl, 1971), class or group-based power (Best, 1976; Castañeda, 2017; Fairfield, 2010, 2015; Richter, Samphantharak, & Timmons, 2009; Timmons, 2005), race (Lieberman, 1994; Przeworski, 1996; Stokes, 1996, 2001; Weyland, 1984; Mahon, 2004; Thirsk, 1997), this research relies on experimental methods that enable identifying the particular features of tax policy that elicit political support among the public. This study suggests that design features can help to craft more palatable taxes in the eyes of the population, providing a fruitful avenue for future research.

Second, whereas the public opinion literature on tax compliance—e.g., why people cheat on their taxes under a given set of rules—is well developed (Alm, McClelland, & Schulze, 1992; Bergman, 2009; Cummings, Martinez-Vazquez, Mckee, & Torgler, 2009; Fjeldstad & Semboja, 2001; Slemrod, 2002; Torgler, 2002, 2005) this study helps to move forward the tax literature beyond compliance. While understanding the reasons why people evade taxes has important implications for extraction, it is just as important to consider the conditions under which greater tax burdens might become acceptable—a step that takes place earlier in time and before tax obligations are due. This is because political support is crucial for both the adoption and sustainability of economic reforms (Stimson, Mackuen, & Erikson, 1995). However, whereas public opinion studies on political support behind reforms such as trade liberalization or privatizations in the developing world abound (e.g., Baker, 2003, 2009; Bratton, Mattes, & Gynah-Boadi, 2005; Buendía, 1996; Checchi, Fiorio, & Carrera, 2009; Johnson & Kowalska, 1994; Przeworski, 1996; Stokes, 1996, 2001; Weyland, 1998, 1998a), those focusing on political support behind taxation are scant.

Third, whereas the relationship between security and taxes has been typically examined at the macro level—e.g., whether the demands from war have generated increased taxation (e.g., Scheve & Stasavage, 2010; Tilly, 1992)—and mostly in historical perspective, focusing on the period of early state formation (e.g., Baker, 2003, 2009; Bratton, Mattes, & Gynah-Boadi, 2005; Buendía, 1996; Checchi, Fiorio, & Carrera, 2009; Johnson & Kowalska, 1994; Przeworski, 1996; Stokes, 1996, 2001; Weyland, 1998, 1998a), those focusing on political support behind taxation are scant.

The rest of the study proceeds as follows. First, it situates this research in the literature on the importance of public opinion for policy making in general and taxation in particular. Next, it discusses theoretical considerations as to how design features might reduce uncertainty in the fiscal exchange—and therefore opposition to taxation—and formulates corresponding hypotheses. Third, it discusses the research design, providing details about the experimental protocol as well as context for the public safety scenario. The fourth section presents results, and the last section concludes with implications for theory and policy.

2. Public opinion and taxation

Stimson et al. (1995, 544–545) have highlighted the connection between public opinion and policymaking: politicians tend to adjust their ideal policy positions as a function of public opinion, along with other factors, in order to get closer to an expediency point—where they believe they do not jeopardize their reelection chances. This process shapes policy decisions by rational anticipation (1995, 545) and can potentially shape electoral outcomes if the public’s views are not heeded. This does not mean that mass public opinion is the only important factor, or more important than the views of or pressure exerted by elites. Rather, this suggests that, without public support for a policy, politicians will have a harder time advancing their agenda: legislators face electoral disincentives to go against their constituents and executives will have trouble garnering legislative majorities.

The question is whether this logic extends to all policies or whether some areas of public policy are removed from public attitudes. One camp suggests that public opinion does not matter for the adoption of tax policy: instead, distributive battles are waged among elites and voters are not relevant in the process (Alesina & Drazen, 1991). This perspective would point to the lack of empirical evidence behind the Meltzer-Richard model of taxation (1981), which focuses on the position of the median voter in the income distribution as the driver of whether taxation increases or decreases. Whereas this model would expect redistribution in unequal societies, democracies have not successfully reduced inequality on average through progressive taxation.

However, while it is tempting to assume that the public might not matter in the policy process for taxation because of this disconnect, it is important to remember that the Meltzer-Richard model rests on several simplifying assumptions that often do not apply in developing countries: that income is the only tax base, there is no avoidance evasion margin, and the median voter is in control of tax policy (Besley & Persson, 2014, 108). Nor does this model consider that the bulk of the redistribution takes place on the government expenditures side.

A competing and more persuasive perspective suggests that even the best policies fail in the absence of the right political conditions to make them amenable to the public and sustainable over time (Armijo & Faucher, 2002; Haggard & Kaufman, 1995; Haggard & Webb, 1994; Schneider, 2004). With an emphasis on structural reforms during the 1980s and 1990s, a large literature pointed to the importance of support among the population as a key factor for the political realization of economic transformations in Africa, Eastern Europe, and Latin America (Baker, 2003, 2009; Bratton et al., 2005; Przeworski, 1996; Stokes, 1996, 2001; Weyland, 1998, 1998a).

On tax policy in particular, scholars have observed that tax reforms are closely related to legislative battles over the distributional consequences of policies (Ferranti, David, Ferreira, & Walton, 2004), and public attitudes play a significant role in determining whether an additional tax burden is adopted, at least in a democracy (Fjeldstad, Schulz-Herzenberg, & Sjursen, 2012). This

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1 Whether similar factors affect compliance and support for reform is an empirical question that remains to be addressed. By advancing our understanding of the determinants of political support for reform, this article contributes toward this end.
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