Financing the Developmental State: Tax and Revenue Issues

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Abstract

This paper focuses on the concept of the developmental state, the conditions of its consolidation, especially in the perspective of the modes of financing it requires. The issues of taxation, public revenue and spending, are examined, because they constitute crucial elements in the building of viable developmental states, and are problematic in least developed countries, especially in Sub-Saharan Africa. The concept of the developmental state stems from the analysis of fast-growing Asian economies. Its elements are presented, particularly the fact that they rely on low levels of taxation and public spending, at least at the early stages of their development. The principal elements and constraints regarding taxation in Sub-Saharan Africa are then analysed, in particular its dependence on commodities and external trade, as well as the effects of the programmes of international financial institutions, in particular trade liberalisation, which appear to be mixed. The constraints that affect aid in the building of developmental taxation systems and states are also examined. Aid provides incentives that may undermine tax structures and key state institutions of recipient countries, such as policy credibility and political legitimacy. Firstly, it is shown that the key features of developmental states are the capacity for a state to credibly commit and intervene, more under the form of policies that are directed towards growth than taxation policies. These states relied on a series of ingredients: intervention of the state in the economy via credible policies oriented towards growth, capacity to address coordination failures and to reallocate factors of production, coalitions between the state, private firms and the civil society. These ingredients cannot be disentangled from political dimensions, growth having being instrumental in the building of legitimacy. Secondly, it is argued that for a policy or an institution to be effective, it needs to be credible and result from endogenous processes. These conditions for developmental states and institutions are currently to be built in most Sub-Saharan African countries. The difficult question remains as to whether foreign aid, given the intrinsic asymmetry of conditionalities, aid dependence and budget constraints, can contribute to the building of developmental states and policies that could be credibly committed towards growth.

Introduction

This paper focuses on the concept of the developmental state, as well as the conditions of its emergence and consolidation. Among other dimensions, the modes of financing of the developmental state constitute a crucial issue, in particular taxation and spending, which are major problems in least developed countries. During the last two decades most of the poorest countries implemented reform programmes that international financial institutions (IFIs) conditioned their financing upon. Because of the absence of private flows - especially foreign and private investment - and an increasing deficit in international credibility ensuing from the debt crisis in 1982 and contributing to a vicious circle of slow growth, the IFIs became the main players and creditors in these countries. As is well-known, the IFIs recommended a series of economic reforms, especially privatisation and liberalisation. A recurrent question is that some of these reforms may have limited the conditions for developmental states to emerge, in particular, the decline in revenues caused by trade liberalisation.

In addition, financing and taxation systems also constitute institutions and their functioning depends on the classical ingredients of effective institutions, i.e. credibility and trust between the state and civil society. Revenues are an essential dimension of the building of credibility and trust as well as reducing external assistance and aid dependency. Many least developed countries, however, are caught in a vicious circle where citizens distrust the state and therefore consider that the state-citizen contract is broken and that there is no justification for paying taxes, which thereby further weakens the capacity and credibility of the state.

Constraints have been simultaneously domestic and international, political and economic. Foreign investors may have viewed least developed countries as providers of natural resources, which does not require institutional consolidation and may even necessitate mere off-shore extraction[1]. These countries have also been viewed as risky or insufficiently profitable - Sub-Saharan Africa (SSA) is thus perceived as the most risky region in the world[2] -, and their policies as non credible and subjected to recurring reversals. This led the IFIs to act as 'lock-in devices' and substitutes for domestic policies that became non credible both for domestic and international investors[3], which in another vicious circle aggravated the poor credibility of governmental policies because of the external character of IFIs conditionalities. In addition, for historical and political economy reasons stemming from processes of state formation, many least developed countries exhibited features that were more 'predatory' than 'developmental'. In turn, these political economy and institutional processes contributed to the drying up of external financial flows as well as domestic savings and investment, and even to the evaporation of the scarce existing resources through capital flight. Sub-Saharan Africa is indeed characterised by a high level of capital flight, which is fuelled by debt – and hence aid – which in another vicious circle is fuelled by these massive capital outflows (Ndikumana and Boyce 2002[4]).

Two arguments will be explored. Firstly, it is argued that taxation systems, as apprehended, e.g., via indicators such as tax/GDP ratios, levels and structure, are insufficient to explain the determinants of a developmental state. The lessons of Asian developmental states have shown that state intervention is a crucial feature, but more under the form of policies that were directed and committed towards growth than under the form of property rights, ownership of important shares of national assets (e.g., state-owned-enterprises), large levies, recycling of national wealth and redistribution.

Secondly, for a policy or an institution to be effective, it needs to be credible and perceived as a commitment, and result from complex, lengthy and endogenous processes. Effective and credible states and institutions have often been lacking in least developed countries, especially in SSA. A key problem is that because of their objectives and procedures, IFI reform programmes—and the device of foreign aid more generally—are currently not well-equipped for helping to the building of domestic effective institutions, policies and commitments towards growth, as well as endogenous processes such as trust between governments and their citizens.

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[1] This is argued by Reno, see e.g., Reno (1998).
[2] These are the theses of Collier and Patillo (2000).
[3] This has been first analysed by Rodrik (1995).
[4] They show that in the 1970-1996 period, roughly 80 cents on every dollar that flowed into the region from foreign loans flowed back out as capital flight in the same year.

The paper is organised as follows. Section 1 examines the main features of the concept of the developmental state. Section 2 analyses the traits of the developmental state in terms of taxation issues, and highlights those of ‘anti-developmental states’. Section 3 presents the principal elements and constraints regarding taxation in Sub-Saharan Africa. Section 4 indicates a series of effects of IFIs programmes. Section 5 examines the current limits of aid in the building of more effective and developmental taxation systems and states.

1. The concept of the developmental state

In a long-run perspective, developing countries exhibit striking variations in performance despite comparable initial levels of income. As an example of what has been coined as ‘convergence clubs’ (Pritchett 1997 and 2000), the UNIDO Industrial Development Report (2005) distinguishes four groups of countries in terms of their prospects for catching-up: the countries that began with below-average GDP per capita and experienced higher-than-average growth for a long period of time – indeed, the ‘developmental states’, Japan, Taiwan, Korea and Singapore[5]; countries in the early phase of catching-up, comparable to the first group (China, India, Indonesia and Thailand); countries having started with higher-than-average levels of GDP per capita, which fell below the average in the second half of the 20th century[6]; and countries that started at a low level of income and fell further behind, such as SSA countries. If any comparison between Asia and Sub-Saharan Africa may be viewed as flawed given the heterogeneity of historical, political, economic and social condition, this sets the context and contrasts that are striking in several domains.

The concept of the developmental state continues to be a fertile conceptual issue in development economics more than a decade after its formulation, for it has explained the exceptional growth performances of East Asian countries as resulting simultaneously from a specific combination of economic, political and institutional structures. It was drawn up to describe the processes underlying the spectacular growth of North-East Asian late industrialisers - Japan, Korea and Taiwan (Hong Kong and Singapore being more particular cases)[7]. Late industrialisers have developed very diverse industrial structures – e.g., small firms in Japan and Taiwan vs. large conglomerates in Korea. They all, however, grounded their industrialisation on learning processes and the borrowing of technology rather than on creating new products. Developmental states have relied on active development strategies, especially industrial policies – as ‘entrepreneurial’ states, more engaged in ‘creating winners’ than ‘picking them’[8]. Industrial policies have involved targeted taxation, protection, limitation of foreigner shareholding, incentives for the banking sector and firm financing, and training in technology, all built around long-term relations between political power and the private sector, as well as between banks and public and private firms (the ‘alliance capitalism’)[9]. Developmental states have used heterodox economic policies, e.g., state intervention in the economy and even political rent-seeking[10], but these public policies were tuned to market sanctions, i.e. export performance.

Industrialisation strategies were characterised by long-term flexibility while relying on short-term, rigid, regulatory measures aimed at encouraging the strengthening of institutions[11].

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[5] And some European countries: Ireland, Finland, Norway, Portugal, and Spain.
[6] Such as Argentina, Chile and Venezuela
[7] Among a vast literature, the pioneering work of Johnson (1982), White (1988), Amsden (1989), Wade (1990), Evans (1989), Aoki et al. (1997); the following presentation of the features of the developmental state draws and is analysed in more detail in Sindzingre (2004).
[8] Wade (1990).
[9] Wade (2000).
[10] For the Korean *chaebols* or the Japanese *zaibatsu* and *keiretsu.*
[11] ‘Flexible rigidities’, coined by Dore (1986) for Japan; see also Chang (1995).

Developmental states have given priority to the autonomy of the technocracy vis-à-vis political power, but which is 'embedded' in society and private sector and industrial networks[12]. State intervention was linked to the notion of 'public service'[13]. Education and training, particularly within the civil service, were key strategies, in addition to the minimal use of foreign expatriates, and an emphasis on infrastructures[14]. Public intervention was circumscribed and targeted on growth. Asian late industrialising countries have implemented social policies that also involved non-state entities, e.g., families and firms, and have spent little on welfare directly, while keeping the role of the state as a regulator and guarantor of the application of social welfare programmes[15].

The core features of the developmental state may therefore be described as the intervention of the state in the economy but under the form of policies that are credible and oriented towards growth, not of the ownership and direct control by the state of large pieces of the economy. Developmental states therefore did not rely on high levels of tax collection and massive redistribution and transfers. As emphasized by Knowles and Gerces-Ozanne (2003), government spending in Asian states is an irrelevant proxy for state intervention: for example, governments issued instructions regarding what to produce and used various incentives and rewards, political as well as economic, they influenced resource allocation in modifying relative prices, used subsidies and so on. Some features appear common to developmental and SSA states: low tax/GDP ratios (i.e., limited redistributive capacities and the absence of welfare states), dependence on external demand, foreign direct investment and investors perception, overlapping of private and public interests, the reliance on rents and natural resources in the case of South-East Asia.

Corruption was also pervasive in developmental states - the so-called 'Asian crony capitalism'[16]. In Korea for example, the policies that led to growth have been explained as firstly a result of political considerations that largely relied on exchanges of bribes between state and business and 'money politics'[17]. After the Asian crisis in 1997, the original modes of alliance with the banks of the *chaebols* (the large Korean conglomerates) were presented by the IFIs as examples of bad corporate governance and corruption. However, specific modes of interaction between international conditions—geopolitical interests, multinational firms' strategies —, domestic politics, institutions, and economics—as well as public intervention in the economy (e.g., capacity to implement policies)—have enabled these Asian states to engage in developmental trajectories.

The history, characteristics and development paths followed by Northeast Asian and Southeast Asian countries obviously differ, but the literature has highlighted important commonalities. The latter refer to what the 'founding fathers' of development economics had revealed after the WWII, before the pre-eminence of neoclassical thinking resulting from the so-called 'counter-revolution', i.e. the necessity of government intervention. Two instruments are crucial: public policies and public institutions. It is argued here that both must be credible for being effective. As shown by Irma Adelman (2000), among others, at early stages of development government intervention is required for the reallocation of resources and factors, capital and labour, which markets alone cannot achieve, or only in a sub-optimal way. She also insisted that there are several paths to development and that there is no correlation between a particular institutional standard and growth. This argument has later been confirmed by a large literature on the

[12] Evans (1995).
[13] Because of its conception of the missions of the state, France has been analysed as a particular form of developmental state; see Loriaux (1999).
[14] Brautigam (1995).
[15] See Garrett (1999) on the comparison of government spending across the world.
[16] Or the well-known 'ersatz capitalism', coined by Yoshihara (1988).
[17] On corruption as a central dimension of the developmental state in Korea and the Philippines, Kang (2002a and b).

relationships between institutions and growth, e.g., Dani Rodrik and economic historians such as Kenneth Sokoloff and Stanley Engerman[18].

Other 'founding fathers' such as Paul Rosenstein-Rodan or Albert Hirschman have shown that developing economies are characterised by coordination failures and the absence of linkages, which hinder spillover effects, cumulative virtuous processes and induce the formation of poverty traps. State intervention is thus necessary in order to create the conditions for coordination between sectors and economic agents and facilitate learning processes[19]. This line of thought shows that in essence state formation and public institutions result from historical processes, cumulative causation, path dependence and lock-in phenomena, and that small changes may generate virtuous processes or development traps. For developmental state theorists, a key feature is that in developing countries market forces alone cannot induce economic growth. State policies were 'getting relative prices wrong' but conditional on developmental objectives[20].

Another point revealed by the concept of the developmental state is that ingredients of growth cannot be considered in isolation: alone, each feature of Asian developmental states did not automatically lead a country to growth. For example, the coordination between public and private agents can amount to mere collusion in some contexts and a condition for development on others[21]. It is the combination of several economic, political, social factors in a given space and time that resulted in development outcomes. In a recent paper, Dixit (2006) underlined that any 'growth diagnostic' must include many factors simultaneously.

Regarding institutions, as shown by Sindzingre (2005a and b), the combination of institutions with other institutions and the effectiveness of their functions are more important for growth than their formal existence. It is now acknowledged even by the IFIs that there is no 'one size-fits-all', no recipe of a particular type of policy and economic institution that may be conducive to a developmental state and an effective type of taxation. This is also the case of institutions themselves. In a theoretical perspective, the developmental dimensions of an institution—political, economic, social—can be assessed not ex ante but ex post. An institution is indeed not a single entity that can be analysed in isolation but which results from the combination of many other institutions and norms, with various forms and contents, and which is historical, path dependent and determined by contexts. Institutions result from continuous processes and combinations, and a role of the state may be to create these when they are lacking (as highlighted by Albert Hirschman) and when economic agents are affected by coordination and information problems.

2. Financing the developmental state

Dimensions of taxation

Financing the developmental state could be achieved at the external level via foreign direct investment, debt, and aid, and at the internal level via taxation – public revenues and spending -, domestic private saving and investment. Taxation is a dimension of the developmental state because the structure and organisation of taxation are intrinsic aspects of state formation. The fact that a state has the capacity to levy a share of the wealth of its citizens defines it as a state. The modalities of this levy define the type of relation a state has with its citizens ('contract',

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[18] Among many others, Rodrik (2004), Engerman and Sokoloff (2003).
[19] A synthesis is in Bardhan and Udry (1999); on the Asian development model, Thorbecke and Wan (2004).
[20] See Amsden (1989) on Korea.
[21] On public-private linkages as a dimension of the development state, see Shafaeddin (2005).

'arbitrary rule')[22]. The fact that the state can levy on transactions between individuals defines its territory and its borders. In a historical perspective the ways states tax their citizens and the nature of taxed goods (e.g., salt, land, labour or capital) denote its rights and duties and a conception of justice and equity, as do the ways states spend and redistribute what has been extracted[23]. The modalities of extraction and redistribution (e.g., which levels, which goods, which social groups) are the basis of policy credibility, in particular the perception that the state is not captured by particular interest groups and that its policies are oriented towards the public good; similarly, these modalities determine the size of the social groups that provide their political support (e.g., 'populist', 'oligarchic' policies) and are therefore the basis of political legitimacy.

The economic theory of taxation is a pillar of public economics. Taxation is viewed as an important factor of growth[24], and it may be said that the disparity in long term growth rates stems from differences in national public policies, especially tax rates, because they affect the incentives to accumulate physical and human capital. In terms of the level and structure of taxation, the literature is inconclusive as to its optimal level[25]. Taxes that finance unproductive expenditure adversely affect growth, whereas taxes used for productive expenditure may have a positive effect. The composition of tax revenue is important (taxes on consumption, e.g., VAT, taxes on labour and capital income). For the IMF, personal income taxes are better-targeted and more equitable but not very effective for helping the poor. A well-known position of the IMF is that low-income countries must diminish their reliance on customs revenues and move from tariffs towards domestic consumption taxes. There is no doubt for the IMF, however, that governments should keep a key role in providing infrastructure, education, and health services (IMF 2005).

As is well-known, there is a positive relationship between per capita income and government spending: as countries grow, the share of government spending in GDP is likely to increase – the so-called 'Wagner law' (Tanzi and Shuknecht 2000). According to this 'law', transfers and the weight of the state in the economy as a recycling device increase with the standard of living, a low GDP per capita being associated with a low level of taxation. Moreover, there also seems to be a correlation between trade openness and the size of government (Rodrik 1998). There is also an apparent correlation between the level of taxation and the importance of the agricultural sector.

In low-income countries, the average ratio of government spending to GDP during the period 1999-2003 was about 29% (34% for middle-income countries, 42% in OECD countries). The tax ratio (tax revenue/GDP) varies widely in low-income countries, from 7-10% in Bangladesh and Rwanda to 30% in Guyana. In the past decade it rose by only 0.5 points in low-income countries (to around 15%). In the 1990s, it was 6.8% in Uganda and 8.1% in Madagascar.

For SSA as a whole, the ratio of public revenues to GDP averaged 23.5% in 2000: in 2003, 17% for Côte d'Ivoire, 12% for Uganda, but 44% (1997) for the country said to be the most 'developmental', Botswana. This ratio approaches half the GDP in some European countries: 36% for the United Kingdom, 38% for Sweden, and 44% for France. The United States, where

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[22] This capacity also defines the boundaries of state sovereignty and control, as explored by Michel Foucault.
[23] For example, the concept of public service in France, elaborated during the 19th century, is linked to an idea of a welfare and paternal state, which can ask much as it gives much, and is a directly accessible public good for all citizens in a 'republic' ('public thing'), without intermediary 'community' membership. This notion of public service is not shared by other European countries, the EU referring to services of general interest, which has a weaker connotation than the 'public service'.
[24] Among a huge literature, see, e.g., King and Rebelo (1990).
[25] In principle, taxation should be taken to the point at which the marginal social cost of raising an additional $1 equals the marginal social value of the additional expenditure or debt reduction that it finances. In practice, the marginal deadweight loss from a tax increase is very uncertain, while the other elements depend on equity judgments upon which people may differ (IMF 2005).

certain sectors are entrusted to the market that are handled by the state elsewhere, has a lower level (17%)[26].

In low-income countries the IMF views a tax ratio of at least 15% as an appropriate target because minimal living standards cannot be sustained at tax ratios below 10%. At a tax ratio of 15%, for most low- income countries, the increase in revenue requires an expansion of the tax base. A ratio close to 20 % is better, as it provides more room for productive expenditure. There is always, however, a tension between taxation and the capacity for a government to provide incentives, such as a low corporate tax rate encouraging private investment.

Developmental states are not Western style welfare state democracies. Developmental states in East Asia relied on the state intervention for the industrial 'catch up', but this interventionism did not mean large public sectors and 'big governments' (as in the Western welfare states). Their tax to GDP ratio is rather low, even lower in average than in SSA (in 1990 and 2003, current revenues in the East Asia-Pacific region averaged 12 and 11% of the regions' GDP). The developmental dimension of the state refers to the quality of the bureaucracy and its effectiveness in supporting the industrial sectors that meet export performance criteria, as in South Korea. China is an example showing that when economies grow the share of public spending increases (now at around 23% of GDP, according to the OECD, 2006). The key issue is the content, policies, and allocation of incentives to specific sectors that contribute to growth and make it so that most citizens may participate in the moves towards growth. This is obviously more difficult in unequal and fragmented societies, such as in SSA.

The redistributive and social capacities of states that recycle only about 10% of the national wealth are obviously limited. In the context of predatory and clientelist politics, and in the absence of developmental objectives at the highest political level and of an 'autonomous' bureaucracy committed to these objectives, these limited capacities challenge the credibility of the state vis-à-vis the citizens. They challenge its capacity to promote developmental or industrial policies as well, particularly costly policies such as the building of infrastructure or selective subsidies. In absolute terms wealth is very limited since most SSA states are classified among the poorest countries in the world, with a GNI per capita of $500 (2003) (the GNI per capita for low-income countries being at $440[27]).

A key dimension of the Asian developmental states and factor of growth that has been missing in SSA is the capacity of making public-private alliances and promoting private firms, be it for motives of collusion or personal enrichment. In SSA, the limited developmental dimension of states is not compensated by a dynamic private sector, which post-independence governments did not support for political economy reasons, as they felt threatened by its autonomy. The type of private sector that was accepted had to comply with the patronage rules. The vulnerable political legitimacy of rulers led them to discourage the few local private activities that were not under their control and could become potential sources of financial support for political oppositions. Private accumulation was obtained mainly from state resources (e.g., SOEs). This ambivalence, or even antagonism, towards the national private sector, composed either of politicians who were 'bought' through public resources, or of entrepreneurs who are frequently harassed and tempted by politics, is typical of many SSA countries – and a cause of their lack of growth.

The share of the public sector to GDP remains high after two decades of adjustment. SSA gross public investment has been stable at around 5% of GDP over the 1990s and around half of gross private investment (13.2% of the GDP in 2003[28]). Domestic credit to the private sector

[26] World Bank, *World Development Indicators 2003 and 2005*, table 4.11 and *World Development Indicators 2000*, table 4.13.
[27] World Bank, *World Development Indicators 2005*, table 1.1.
[28] World Bank, *African Development Indicators 2005*, tables 2.9 and 2.10.

represented 63.7% of the GDP in SSA in 2003, compared with 123.6% in East Asia and the Pacific, and 158.3% for the high-income countries – but other regions fare worse: 25.7% in Latin America and the Caribbean[29]. In contrast with developmental states, SSA governments may be 'entrepreneurial' but mainly in a public ownership and control framework (state-owned enterprises), and they do not give priority to the national private sector.

In some countries after independence (such as Côte d'Ivoire), it is to the foreign private sector that subsidies and exemptions were granted. Four decades later global trade openness and competition between developing countries to attract international capital and FDI through tax exemptions—which are denounced by Rodrik (2001)—have introduced additional constraints: they may have positive effects for domestic firms (via FDI) but limit the options regarding the broadening of the tax base. In SSA, local banking sectors have not given priority to the national private sector either[30].

Ingredients of the developmental states: policies, credibility, legitimacy

The developmental state is simultaneously an economic and political phenomenon: it is impossible to dissociate its choice of policies or the capacity to implement them from specific political objectives and interests, consolidation of political support and constituencies and particular political regimes. Policies would not have been implemented in the absence of credible and legitimate institutions and political regimes. In the Asian developmental states, policies were oriented towards growth, and especially the model of growth that was oriented towards exports, without the necessity of a state that collects and recycles much of the assets and flows of the economy. Public policies played a more important role than levels of taxation, as well as specific institutional environments and degrees of institutional consolidation.

Taxation is addressed by political economy theories, e.g. theories of self-interested rulers, rent extraction or predatory states. The fact that a state may be a democracy or an autocracy is not a key criterion for a state to be developmental. There is a huge literature and hot debates on the relationship between democracy and growth, but with different conclusions[31]. The developmental state model is not associated with a specific type of political regime, even if it is frequently associated with authoritarian regimes[32]. The relationship with a specific type of political regime must in any case be analysed on a case by case basis and how it has changed over time. The developmental state appears to be a strong state. The institutional strengthening of these states over time has stimulated economic growth, which in turn has furthered the cause of democracy. The point is that it is strong not because it owns and control, but because it has the capacity to credibly commit and implement policies (to make credible promises as well as threats), change property rights and provide incentives both for private and public agents, be it in a coercive manner.

On the other hand, in the context of weak institutions as in SSA, democracy may aggravate weakness and social polarisation. It has sometimes revealed the fragility of the links of citizens to the state and accelerated the centrifugal demands from various constituencies. It may have reinforced demands of having more political and economic power especially through ethnic idioms.

Besides the issue of the political regime, a key question is the nature of the ingredients of the building of trust between citizens and the state, which could underlie a developmental revenue

[29] World Bank, *World Development Indicators 2005*, table 5.1.
[30] For example, in Côte d'Ivoire in 1993 most banks only gave loans to foreign companies (de facto French) (Sindzingre 1996).
[31] The literature is huge: see among others, Bardhan (1993), Przeworski and Limongi (1993), Przeworski et al. (2000), Tavares and Wacziarg (2001).
[32] A discussion of the democratic dimensions of the concept of the developmental state is in White (1998).

system. Credibility and legitimacy in the sense of the acceptance of a social contract between the rulers and the citizens have been viewed as a feature that is common to Western welfare states and Asian developmental states. Growth and the success of export policies provided incentives for collective behaviour oriented towards enrichment and a virtuous circle towards growth.

In contrast, in the poorest developing countries, credibility and trust are constrained by the fact that policies and spending are severely limited by the trade off between policies oriented towards growth, e.g., promoting investment and infrastructure, on the one hand, and the necessary social and poverty reduction policies, on the other hand – and precisely because these countries are poor. This trade off was a central focus of the early thinkers of development (e.g., Nurske, Rosentein-Rodan) and the reflections on the balance-of-payment -constrained growth. It highlights the inherent distributional conflicts at early stages of development (Storm 2005). Vicious circles therefore easily develop, as in SSA. The lack of credibility of the state and its policies along with the lack of trust from citizens justifies tax evasion, thus generating further scarcity of resources and therefore the incapacity of states to provide basic services, which in turn increases the state's lack of credibility. History obviously matters, as does political ideology, the role of neighbours (e.g., Japan and China; SSA countries have not benefited from the institutions of neighbouring countries). As is well known, the weak credibility of SSA states contrasts with the long time existence of states and elaborate bureaucracies in Asia. Some studies have even found a relationship between the 'antiquity' of the state and economic growth[33].

An issue that contributes to vicious circles, both as a cause and effect, is informality. Informal sectors are important in SSA, and indeed the available figures are impressive. In SSA, despite the vagueness of this concept, state redistributive capacities are limited by the importance of informal sectors. The so-called modern sector only provides 10% of jobs, and in the mid-1990s formal employment only accounted for about 3% of employment in industry and 9% in services[34]. The informal sector often contributes as much as half of the GDP and of employment. Informalisation seems to have increased after the 1980s in some countries with stabilisation and structural adjustment programmes. For example, the informal economy is said to constitute 92% of the total job opportunities outside of agriculture for women in SSA and 71% for men[35]. The ILO estimates that informal employment represents between one-half to three-quarters of non-agricultural employment in developing countries (48% in North Africa, 51% in Latin America; 65% in Asia, 72% in SSA), but the figures are higher if informal employment in agriculture is included. The informal sector (i.e., informal enterprises) as a percentage of non-agricultural GDP is estimated by the ILO at 41% in SSA[36].

In terms of taxation, however, the informal sector should not be viewed as the other side of a dualism. As shown by Sindzingre (2006), the unrecorded character of informal activities is more a matter of continuum than a binary dichotomy. In many developing countries informal activities are registered by state services based on a series of documents. Informal firms also pay taxes, such as marketplace taxes, licenses, taxes on equipment, and the like[37]. If most firms do not comply with the totality of legal obligations, in most cases at least a segment of their activity is registered with some agency of the state or indirectly through their relationships with a formal firm or financial institution. Certain survey samples are even constructed on the basis of the files kept in the revenues services, e.g. municipal licenses. The size of the informal sectors may also be important in Asia but it is related to different contexts in terms of incentives

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[33] As coined by Putterman et al. (2001).
[34] Adenikinju and Oyeranti (1999).
[35] Becker (2004), quoting ILO (2002a).
[36] ILO (2002b).
[37] As shown by Morrisson (1995): in his surveys, e.g., 2/3 of microenterprises and self-employed were paying taxes in Thailand and ¾ in Tunisia.

regarding entrepreneurship. Furthermore, in some SSA countries the specificity of social norms, such as membership norms, contributes to the fragmentation of social interactions and collective action[38]. SSA suffers from 'shorter' networks and diasporas, which have contributed to the consolidation of the developmental state model and of export-based growth[39].

Some rulers may not wish for development and have therefore been called 'anti-developmental' rulers[40]. They generate endogenous economic and political economy processes that lead to 'no-growth' traps. If the link between democracy and growth remains controversial, the relationship seems more robust between growth and political stability (Przeworski et al. 2000). It shows that the time frame of rulers is a key dimension of development. The key difficulty, however, is to have ex ante criteria that would differentiate the long term horizon of a benevolent dictator from a predatory ruler[41]. Dictators who have long term time horizons – usually for remaining in office – may have incentives to build constituencies and support from specific social groups in order to stay in power. In contrast, some types of political regimes – predatory and kleptocratic dictatorships that rely on pure coercion, because rulers have a long time horizons — may be genuinely anti-developmental. For the latter, growth — indeed any institutional development — may imply a threat, as it may create uncontrolled resources and hence challengers[42]. Taxation may be irrelevant, given that resources are based on extraction.

The developmental state is grounded on coordination, spillover effects between the public and the private sector, coalition of rulers, elites and interest groups, with the common belief that long term growth is of the interest of all, even through collusion and corruption. As shown by Kang (2002b) in regard to Korea, corruption could be kept under control because political and economic groups were in a 'mutual-hostage' situation. Typically, many low-income countries exhibit an opposite political economy, which is based on the 'divide and rule' principle (Acemoglu et al. 2004).

Likewise, notions of weak and strong states are difficult to define ex ante, as is the prediction of their respective economic outcomes. Acemoglu (2005) defines 'weak states' as states that lack the power to tax and regulate the economy and to withstand the political and social challenges from civil societies. Weak states can be detrimental to development and taxation, though as argued by neoclassical economics, minimal states may be more efficient. Ex post, strong states are too strong if they do not work towards development and just create harmful distortions; and they are not strong enough when they fail to invest in public goods. A developmental government appears rather as a combination of features and policies resulting in equilibria that emerge ex post.

3. Features of taxation in low-income countries: the case of Sub-Saharan Africa

The constraints on revenues: trade-based taxation, commodity dependence and price volatility

Revenue collection in SSA displays distinct characteristics in comparison with Asian developmental states. Public revenue is severely constrained in many least developed countries because it relies on external trade, as in SSA. The fact that growth in poor countries, as with the collection and the amount of taxes, relies on trade and volatile resources generates structural problems both for budgets and economies. As emphasized by Nicholas Kaldor (1963): "Will

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[38] This relationship has been explored in detail in Nissanke and Sindzingre (2005).
[39] See for more details, Malaizé and Sindzingre (1998), Sindzingre (2005c), Rauch (2001).
[40] The ex-Zaire has been analysed as a paradigmatic case (Robinson 1996),
[41] As both Lee Kwan Yew and Mobutu had long term time horizons.
[42] This is explored at length by Daron Acemoglu, James Robinson and Simon Johnston; see Robinson (1996), Acemoglu and Robinson (2000, 2006).

Underdeveloped Countries Learn to Tax?": he had already observed that incentives for collecting taxes, i.e. the basic functions of the state, might be undermined by an over-reliance on external resources[43].

Post-colonial features of taxation in SSA were adverse to the consolidation of a developmental state because of the importance of agriculture. As is well-known since the colonial period, taxing farms, agricultural producers, households and individuals has been notoriously difficult[44]. The typical persistence of fiscal deficits in SSA has structural causes that stem from the nature of revenue. Exports of primary products constitute an important share of revenues, which are therefore affected by the well-known problems of commodity dependence and price volatility. The industrial base is narrow and economic activity remains based on agriculture and services. The latter refer to a range of activities that are 'informal' and do not pay taxes, and which generate little income (as in the case of petty traders). Structural deficits are compounded by the fact that poor states are constrained to spend on infrastructure because they are poor and in the process of state-building. The profitability and revenue from infrastructure projects, however, is low, especially as they intrinsically have a social dimension.

In theory taxes can be collected on external trade, commodity production, economic transactions, profits of firms and individual income. However, poverty, weak institutions, political economy, strong asymmetries of information and informational problems, and commodity dependence severely limit the possible options and their feasibility. Moreover, they all have different implications in terms of equity. As summarised by Aizenman and Jinjarak (2006), tax bases hence go from 'easy to collect' taxes (e.g., tariff, seigniorage) towards 'hard to collect' taxes (e.g., VAT, income tax).

Therefore taxes on the production and export of commodities, and on external trade have played a key role in SSA, as they have been easier to implement. These taxes were levied on the main export crops: e.g. cocoa and coffee, in Cote d'Ivoire, Ghana, and Cameroon, cotton in Sahelian countries, etc. As shown by Teal (2002) in the case of Ghana, a constant feature of economic policy, both before and after the adjustment era, is the importance of the taxation of agricultural producers for exports. The real depreciation of the exchange rate after the launch of the reform program in 1983 was matched by a fall in the world price in cocoa and a rise in the tax rate on cocoa. The tax rate on cocoa remains unchanged and the average tax rate on cocoa in the 1990s (58%) was the double of its level in the 1900s (24%).

The taxes that were managed by parastatal offices such as stabilisation boards or marketing boards often became inefficient. The resources levied on agricultural producers were supposed to smooth the volatility of international prices and compensate losses in income in the event of a drop in prices. Fiscal constraints, political economy of state formation, patronage politics and corruption, however, made it so that these redistributive functions were rarely achieved. Much of the literature in political economy insisted on the intrinsic biases in public expenditure in low-income countries, as these are characterised by large information failures, manipulation of voter information, status quo biases, social fragmentation, and so on[45]. In addition, prior to adjustment programmes and trade liberalisation, various taxes were levied on exports.

Taxes on imports have remained important sources of revenue for SSA states. They were associated with policies of import-substitution, economic nationalism and a quest for industrialisation as necessary stages in the process of economic growth. As is well known, import-substitution has been heavily criticised by many economists and by the IFIs as inefficient and impeding economic growth. As shown by Azam and Djimtoingar (2004) in the example of the taxation of cotton in Chad, taxation of export commodities associated with

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[43] Kaldor (1963), quoted by Moss and Subramanian (2005).
[44] See Hopkins (1973), Austen (1987).
[45] See, e.g., Drazen (2000) and the many studies by Alberto Alesina, Torsten Persson and others.

tariffs on imports (for protecting the import-substitution industries) may generate immiserizing growth. This type of taxation may indeed introduce a relative price distortion that is an incentive for producing less of the good that is valuable internationally and more of the protected good.

SSA countries rely heavily on trade taxes as a source of government revenue: these taxes account for an average of a quarter of government revenue and several IMF studies show that the latter is aware of this problem (Baunsgaard and Keen 2005). According to other calculations, SSA countries derive about one-third of their total revenue from trade taxes (Agbeyege et al. 2004). Despite a declining trend, trade taxes still accounted for some 5.5% of GDP on average in SSA in 1995 (Ebrill et al. 1999). This is at the expense of domestic taxation (on income or value added). In 1990 SSA was the region in the world that derived the highest proportion of its current revenue from taxes on international trade: 35% in 1980 and 27% in 1990, compared to almost zero for European countries (1% for the United States), with taxes on income and profits in SSA only accounting for 23% of the total. For example, in 2000 taxes on international trade represented 77% of government revenues in Guinea; 41% in Côte d'Ivoire, 36% in Madagascar in 2003. The richer the country, the more the extractive capacities of state are based on taxes on income, property and services, and on social security contributions[46]. More generally, in the mid 1990s tariff revenue exceeded 30% of the government's total tax revenue in more than 25 developing countries, while in high-income countries tariff revenues typically represent less than 2% of total tax revenues (Bachetta and Jansen 2003).

Commodity price volatility has a dramatic impact on public revenues, as shown by oil-producing countries, which after the 1986 shock had to suddenly and drastically cut their budgets (e.g., Gabon and Nigeria). It is obviously difficult to handle budgets that may vary by as much as 100% within a fiscal year or from one year to another, and which are unpredictable given their dependence on international price fluctuations: in Nigeria petroleum revenues represented 82% of total revenues in 2000 and petroleum exports 96% of total exports of goods[47]. In Zambia, trade taxes represented 4.6% of GDP in 1998; with extraction royalties, 27% of total revenue[48]. The IFIs have sometimes proposed off-budget accounts as a solution (as in Norway or Cameroon[49]). The local political economy (e.g., predatory practices), however, may transform it as an instrument for corruption and capital flight.

UNCTAD studies revealed that Sub-Saharan exports experienced twice the volatility in terms of trade that East Asia's exports did in the 1970s, 1980s and 1990s, and four times the volatility that the industrial countries experienced[50]. A well-known and debated issue is the possible existence of the so-called curse of natural resources. Asian developmental states, at least the North Asian ones, had no primary commodities and could not be plagued by commodity dependence, 'Dutch diseases' and the so-called 'natural resource curse'. For some economists, such as Auty (2001), this has been a determinant of the emergence of developmental states in Asia. It is because they were not commodity dependent that they have been able to develop. Many studies consider that commodity dependence prevents state-building, is an incentive for corruption and kleptocracy, and is associated with high inequality. Dutch disease, volatility and the curse of windfall gains affect oil countries as well as poorer countries that produce tropical commodities, the latter suffering in addition from declining prices (cotton, tea, cocoa). UNCTAD studies have also shown that price volatility is a direct cause of unsustainable indebtedness, and therefore poverty traps. Indeed, the concept of poverty

[46] World Bank, *World Development Indicators 2003 and 2005*, table 4. 13.
[47] International Monetary Fund, *Nigeria: Selected Issues and Statistical Appendix, Country Report* 01/132, 2001, p. 4.
[48] International Monetary Fund, *Zambia, Statistical Appendix*, 2001, table 11.
[49] See the analysis of temporary export windfall in Bevan et al. (1990, chap 4).
[50] Based on IMF-World Bank sources, UNCTAD (2001); see also UNCTAD (2003).

trap, analysed by Rosenstein-Rodan as a coordination failure, suggests a contrast point by point between the Asian developmental states and most states in SSA[51].

An instrument such as the VAT has been a key element of IMF stabilisation programmes, in order to modernise tax systems and reduce the harmful effects of the dependence on volatile prices of exported commodities. The IMF stresses that the VAT is a more developmental and neutral tax. The introduction of the VAT has been problematic in low-income countries, however, and especially in SSA, and the IMF acknowledges that it is not easy to demonstrate its efficiency gains due to difficulties in the functioning of the refund and credit mechanisms[52]. The implementation of VAT is subjected to economic and political economy problems, which are also linked to the causes and effects of the existence of large informal sectors, which evolve between informational problems and deliberate underpaying. In the presence of large informal sectors, many transactions do not follow a dualistic structure and often include a formal as well an informal segment. Refunds are often contentious and difficult to achieve[53]. In already corrupt environments, the IMF itself acknowledges that refunding offers opportunities for fraud and corruption, while in poor countries, fiscal problems and cash shortages may lead to the denial of refunds by governments (Harrison and Krelove 2005).

The efficiency of VAT thus results from complex interactions between costs of monitoring and collection, incentives for the collector and the taxpayer, probability of penalty, corruption equilibria and so on, and as shown by Aizenman and Jinjarak (2005), from political economy characteristics such as social polarisation or political instability, or economic factors such as urbanisation or the share of agriculture. In addition, the VAT is not a progressive tax and may weigh on the poor depending on the rates. In that sense it may not reinforce the developmental state, as it may not contribute to reducing inequality. However, there is much variation across SSA countries, with some countries relying more on VAT[54].

Public spending and growth in low-income countries and developmental states

Developmental states do not have particularly large governments. In its initial stages, the developmental state is characterised by a quest for effective and credible polices, and provision of incentives more than large public ownership or employment. In Korea, for example, the levels of public and social expenditure are low, and in the 1980-1997 period, before the financial crisis, the average level of government spending of Korea was around 20% of GDP (compared to some 50% in OECD countries)[55].

Public sectors in SSA were not excessive at the time of the first fiscal crisis that led to the first adjustment programmes in the early 1980s. The weight of the public sector is relatively weak in SSA. Contrary to a conventional wisdom that looks at their low levels of fiscal revenue, SSA states do not have over-sized civil services. The two countries said to have developmental features - Mauritius and Botswana - had higher public employment ratios than the SSA average: in the mid-1990s, 5.5% and 5.8% respectively, compared to 1.5% on a sample of 20 SSA countries, and 2.6% in Asia (11 countries) or 3% in Latin America and the Caribbean (9 countries)[56]. SSA states show a ratio of the number of civil servants/total population that is lower than in developed countries or other developing countries; in 1996, it was 1% compared

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[51] Rosenstein-Rodan (1943), see the modern interpretation by Hoff (2000).
[52] On VAT, see Ebrill et al. (2001).
[53] See FIAS-IFC-World Bank (2006) on the case of Rwanda; the author is grateful to Max Everest-Phillips for having brought this study to her knowledge.
[54] For example Kenya, see Muriithi and Moyi (2003).
[55] See, e.g., Boix (2000, 2001), Kwon (1999), Goodman et al. (1998).
[56] Goldsmith (1999, table 2); see also Sindzingre (2001).

to 3% in other developing countries[57]. The number of civil servants in relation to the total population has sometimes even fallen since the stabilisation programmes in the 1980s.

As is shown by most studies, including the IMF (e.g. IMF 2005), a key aspect of public spending is the macroeconomic context, with the effect of government spending on growth depending on it. In the context of economic instability even government spending that is productive may have a negative effect on growth. Policies may matter more, which has been shown by the Asian developmental states. Public investment may potentially raise economic growth, although empirical evidence on the impact of public investment – or infrastructure investment - on growth or productivity remains inconclusive, as well as the contribution of 'good governance'.

The point is that SSA governments suffered structural fiscal deficits because of the volatility of revenues, and that later the fiscal ceilings put by stabilisation programmes resulted in an increasing share of the wage bill at the expense of investment and maintenance spending. Spending on infrastructure and capital expenditure has declined since the mid-1980s, as did public investment in SSA, both as a ratio of GDP and as a share of total spending. The stock of infrastructure (e.g. roads) is low as compared with Asian countries, even at the latter's early stage of development. The increase in wages at the expense of more developmental expenditure has detrimental effects. It has indeed been shown that the composition of public spending matters. As underscored by Gupta et al. (2005), countries where spending is concentrated on wages tend to have lower growth; in contrast with those that allocate higher shares to capital and non-wage goods and services, which exhibit faster growth.

Stabilisation and adjustment programmes therefore prescribed the diminution of the wage bill and the retrenchment of civil servants. Because of unexpected effects, such as ratchet effects, outcomes have been mixed, witness the attrition of competent civil servants, the lowering of productivity, and informalisation, which have worked in directions opposite of those of developmental public institutions. The political science literature has also underscored features stemming from the history of state formation and the political economy – hiring of civil servants less for their competence than countering political centrifugal forces, clientelism, and the like. These conditions were not favourable to the emergence of the autonomous and technocratic bureaucracy of Asian developmental states.

With the PRSPs[58], the IFIs recommend an enhanced allocation of public expenditure to the social sectors and insist on the importance for growth of the composition of public spending. The question of whether spending in social sectors is conducive to growth is crucial. It is a criterion of the possible contribution of the current IFI poverty reduction strategies to the building of developmental states in low-income countries. Economic theories of human capital have revealed a relationship but which is indirect. Moreover, the time frame of policy reform and results in terms of economic growth are heterogeneous. Causalities involve a series of steps, from spending in the social sectors to better health and education then from health or education to growth. Higher public spending on health and education can build human capital but with varying degrees of effectiveness. As shown by Patillo et al (2005), since the mid-1980s, SSA countries have increased their public spending on education and health, both as a ratio of GDP and as a share of total government spending. An exception is oil-producing countries, where, since the late 1980s, both measures of social sector spending have been declining. They agree with Baldacci et al. (2004) that social expenditures have positive effects on growth in SSA, because of their high marginal returns given lower initial levels[59].

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[57] Lienert and Modi (1997, p. 30).
[58] Poverty Reduction Strategy Papers.
[59] For Baldacci et al. (2004), an increase in education spending of 1% of GDP could increase the net primary enrolment rate by 8 percentage points over a 10-year period; a similar increase in health spending would reduce under-five child mortality by 8% over 10 years.

These positive effects of social spending on growth, however, remain controversial. An important issue is the many intermediary processes and leakages that can occur between the decision to earmark spending to a particular sector and the achievement and effectiveness of the project. In a developmental perspective, the composition and efficiency of social spending are more important than its levels. The IMF and many other studies show that rates of return for primary and secondary education exceed those for tertiary education. Some studies confirm the effectiveness of increased public expenditure on education and health care. For Gupta et al. (2002) it enhances the access to and attainment in schools, and reduces mortality rates for infants and children in developing countries, though the relationship between health care spending and mortality rates is weak. Other good news is that, according to Gupta et al. (2001), the relationship between public spending and the health status of the poor is stronger in low-income countries than in higher-income countries. For other studies, however (e.g., Pritchett 1996), the correlation is weak between spending on education and growth. Likewise, the relationship between spending and increased health care is weak (Filmer et al. 2002). Many other factors interfere in the relationship, such as the lag between expenditures and their returns, absenteeism and behaviour of public employees, the quality of services, market failures, leakages of public funds (Reinikka and Svensson 2004), among others.

A key developmental dimension, especially regarding the building of trust, credibility and a ‘fiscal contract’, is the extension and effectiveness of redistribution, and the management of inequality and individual risks that may push individuals into poverty. The issues of social protection and building of a welfare state are important here. Asian developmental states devised original social policies that initially did not imply high levels of public spending. They did not spend much on social protection and relied on a combination of the state, market and family structures. Asian developmental states made political use of the provision of social welfare. Governments built up social policy institutions and welfare programmes also for domestic political motives, i.e. strengthening their legitimacy and building political support, as in the case of Korea[60]. Developmental state governments were aware of the political advantages of social policy and the inclusion of certain groups in order to secure political support. As revealed by Kwon (2005) in the cases of Korea and Taiwan, developmental states used a ‘selective’ welfare ‘developmentalism’ that relied on the market for boosting growth, defined as a nexus of ‘productivism, selective social investment and authoritarianism’. A key point is that the elements of the East Asian welfare states were incorporated in the developmental strategy, which promoted private sources of welfare and discouraged reliance on the state (Kwon 2005, Goodman et al. 1998).

In SSA, personal rule and the instability of political regimes have not incited post-colonial leaders to make efforts to improve equity. Social protection and insurance have been mostly provided by social networks (Sindzingre 2003). In SSA, since the state provides limited social security, only the possession by an individual of a ‘stock’ of claims over other individuals can provide insurance and make it possible to be covered against risk and uncertainty. Local norms institute mechanisms whereby individuals are included in circuits of rights and obligations. Individuals insure themselves against risks by investing in these circuits, creating social debts and expecting returns, but in SSA their anticipation is itself risky because of poverty, collective risks and opportunities for free riding that accompany social fragmentation. This ‘informal’ social protection may be inefficient, lock individuals through group membership and reinforce the distrust vis-à-vis the state.

The economic and political economy literature has highlighted the relationship between low inequality and growth via various channels, e.g., better education for the poorest groups, and reduced social polarisation and social unrest. In contrast with SSA Asian developmental states, in reducing inequality, have been able to trigger a virtuous circle. The more inequality was

[60] Kwon (1999).

reduced, the more the model of the developmental state could be legitimated and consolidated, as has been the case in Western democracies. The model of the developmental state may be destabilised, however; the Asian crisis was associated with an increase in inequality, a negative impact on education and nutrition, attrition from the educational system, and with possible intergenerational effects, among other things.

In contrast, many low-income countries are characterised by high after-tax inequality, as in SSA. As revealed by Chu et al (2000), the problem in low-income countries is the inefficiency of the tax system and transfers, especially in order to reduce income inequality. Health care and primary and secondary education programs in developing countries are often not well targeted. This is especially the case in SSA, where the analysis by Chu et al. of existing studies show that the poorest quintile receives the least benefits of public spending in health and education (except primary education), and the richest quintile receives the most. This contrasts with Asia, where spending is progressive and better targeted. The analyses by Sahn and Younger (1998) of fiscal and tax incidence in SSA have highlighted the high level of expenditure inequality in SSA. Many taxes and expenditures are progressive, as are most of the benefits of public services in the social sector, but only primary schooling in South Africa is per capita progressive: i.e. even progressive social services go disproportionately to wealthy people. Sahn and Younger recognise the extreme difficulty of means testing, administratively and politically, but underscore how social services and transfers in SSA are insufficiently targeted to the poorest.

In SSA, social policies were often inequitable as they were primarily oriented on already privileged groups such as employees in the formal and urban sector (e.g., civil servants). Before the adjustment era, before the 1980s, growth in itself was supposed to the solution, and social policies were rarely aiming at supporting income or enhancing capabilities of the poor, i.e. focused on education and health. In SSA, social polarisation is an impediment vis-à-vis the achievement of a developmental model. The skewed character of redistribution is reinforced by political economy factors: state resources are captured by various interest groups that are the most privileged and often precisely do not pay taxes via legal exemptions or corruption.

In addition, corruption within the civil service may aggravate the existing problems of collection, progressivity, targeting and redistribution. This is compounded by the weakness of the capacity of tax administrations, which deteriorated under the fiscal constraints of the adjustment period, particularly on account of the reduction of spending on equipment and maintenance (and the related increase in the dependence on aid for, e.g., computers, cars, etc.). A key problem is here the huge discrepancy between local and international wages that are standard in aid projects, which create a 'rate of temptation' that has no ceiling. Vicious circles are also generated by poor infrastructure: even if the tax is collected, it is confronted with poor roads and transportation system as well as inefficiencies of bank transfers and computerisation.

4. The consequences of reform on the formation of developmental states in SSA: stabilisation, structural adjustment programmes and the PRSPs

Stabilisation and adjustment programmes, then the PRSPs, did not address the factors of growth, i.e. investment. It has been argued that their focus on health and education does not directly boost growth, and that PRSPs do not address diversification, investment, learning, acquisition of knowledge, fostering entrepreneurship and the private sector.

Building the ingredients of the developmental state is indeed not the main objective of PRSPs. Fostering the private sector is rather conceived in PRSPs as improving the regulation of the business climate[61], with a type of state that ensures macrostability and addresses market failures,

[61] Examples are the World Bank '*Doing Business*' annual reports directed by Simeon Dkankov.

not a welfare state—viewed as impossible for early stages of development—, nor a developmental state, itself seen as a heterodox and non-replicable model. Programmes in SSA have been severely criticised for being inefficient, among other things, or afflicted with inconsistencies[62]. Many factors must be taken into account, such political economy, history, path dependence, and state formation, which in SSA are manifestly different from those in Asia.

Reforming financial government agencies, reducing fiscal deficits

Financial government agencies in low-income countries were recommended and controlled by the IFIs, as they are crucial for the implementation of stabilisation programmes; but as is well-known, the risks have been a possible contradiction with the goals of 'ownership' and a design more inspired by the donors' model of a civil service than of local specificities. There has been a first generation, focused on economic stabilisation and contraction of the size of government, then a second generation of reforms of civil services, more based on incentives and merit[63], influenced by information asymmetries theories and views of the state as a provider of macroeconomic stability, public goods and the right incentives.

Autonomous agencies for revenue collection were created, inspired by theories of public management. Their effectiveness was mixed, especially in the French-speaking countries. The 'right' incentives and autonomy of agencies sound like features of developmental states, but the political economy context differed and has provided a different content to seemingly similar institutional forms: civil servants may have various goals, not only the provision of efficient public service and public goods, but also the acquisition of a status and resources. In low-income countries, stronger incentives and rewards may be provided by other institutional settings, such as social norms or political systems. The developmental state model cannot be understood outside the specific characteristics of local institutional forms and contents (Sindzingre 2005a). In addition, individuals are caught in various sets of obligations and norms, with markets that are interlinked, e.g. credit, status, land, labour[64], which may create unexpected effects when reforms are initiated.

Reforms aimed at reducing fiscal deficits through stabilisation (IMF) and adjustment programmes (the World Bank). The recessive aspects of IMF stabilisation programmes, focusing on the reduction of 'absorption', have been the object of a large literature. Though they are economically justified, when combined with the instability of resources from commodities, stabilisation has often led to significant cuts in expenditure and with states incapable of providing elementary basic services or even paying their civil servants. In theory, large deficits were said to impede growth, though studies now suggest that the deficit-growth nexus may be nonlinear (Adam and Bevan 2004 and 2005). The level at which deficit reduction no longer boosts growth, however, is subject to considerable uncertainty[65]. Studies of tax systems during that period show various profiles, which were not all inefficient, as well as sustainable levels of deficits, a key problem being data and quality of information on tax for all the players involved[66]. After 1999 these programmes were continued by the PRGF and PRSP, with their link to the HIPC initiative and their stress on poverty reduction, i.e. conditionalities for allocating spending to the social sectors. Regarding revenues, the IMF recognises that the experience with tax policy in developing countries during the 1990s was mixed. Revenue has been stagnant in the poorest countries and has even decreased (Keen and Simone 2004).

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[62] Among many others, see Akyüz and Gore (2001).
[63] Tanzi (2000).
[64] See among others, Bardhan (1989) for explanations of these concepts.
[65] Adam and Bevan (2005) suggest a breakpoint for the overall deficit (including grants) centered at 1½ percent of GDP.
[66] See Ariyo (1997) on Nigeria.

Well-known problems were the intrinsic coercive dimension of conditionality even if it is oriented toward poverty, i.e. inherently an oxymoron vis-à-vis the famous requisite of 'ownership'. Asian developmental states were characterised by a certain degree of homogeneity under strong leadership, be it military. Many SSA societies are characterised by political and social fragmentation, with divisive norms and politics (Nissanke and Sindzingre 2005). IFI reforms may have sometimes contributed to these divisions and segmentation. Even if donors are coordinated among themselves and appear better linked with governments, governments and elites may be separated from other segments of societies. Donors remain by definition external, whatever the procedures of coordination.

In the context of weak states, divisive policies, segmented markets, instead of enhancing coordination and cohesion, and rebuilding states, programmes exhibited an over-optimistic belief in the virtues of the model of the minimal state aiming at the provision of public goods and macroeconomic stability. They left aside other ingredients of state-building that were suggested by developmental states (and the 'Scandinavian model'), e.g., 'more state and more market', the state as a provider of security and cohesion while allowing markets a large flexibility, among other things.

Reforms also assumed a better efficiency of private entities, e.g., privatisation. Privatisation has been efficient in some cases (e.g. in the telecommunication sector) but not in others, e.g., utilities in the power sector. In Asian developmental states, transfers of state assets, contracts guaranteed by the state were implemented by a credible bureaucracy, politicians and businessmen linked by mutual interests. The private sector had relays within the state – the famous 'collusion' – while in SSA the private sector had often been in a situation either of informality, antagonism vis-à-vis the state, or of being supported by the state.

The fiscal effects of trade liberalisation

The reform programmes recommended by the IFIs may have a crucial impact on revenues. In particular, trade liberalisation, a key reform of stabilisation and structural adjustment programmes, then of PRSPs and WTO agreements, has often been said to cause a decline in revenue (via reforms of tariffs, of quantitative restrictions and reduction of export taxes). Trade liberalisation is therefore likely to have a negative impact on SSA countries because of their reliance on trade taxes. Regional agreements, bilateral agreements with developed countries and multilateral tariff reduction also entail trade liberalisation and impact on tax revenues.

As mentioned in Gupta et al. (2005), there has been a clear decrease in trade taxes in SSA between the early 1990s and the early 2000s: from 4.9% to 3.5% of the GDP for the import duties, and from 1% to 0.4% of the GDP for export duties. In the early 1990s tax revenues in SSA represented 16.3% of GDP and 15.9% in the early 2000s. This trend is also found in PRGF-eligible countries, where the tax revenue decreased from 15.2% of the GDP in the early 1990s to 14.8% of the GDP in the early 2000s.

Trade liberalisation has been criticised by heterodox studies, e.g. at UNCTAD, which insist on different types of reforms. They usually consider that for reforms to be developmental it is essential that the poorest countries implement policies that rehabilitate the linkages between domestic sectors and the export sector. For some, e.g., Akyüz and Gore (2001), a core objective of reform should be to stimulate domestic savings and investment, as the latter are very low in SSA. Reforms should therefore include a focus on the enhancing of policy, institutional, and political economy credibility, employment and be careful about the potential negative effects of deindustrialisation both on the prospects for growth, the balance between economic sectors, and state capacity.

In this regard, trade liberalisation in SSA led to mixed results. For many economists, trade liberalisation did not provide a basis for long term growth. In particular it did not help to reduce economic vulnerability to external shocks, nor help to diversify economic activities and exports from the dependence on natural resources. In changing relative prices, trade liberalisation may also destabilise social arrangements and compromises. It may lead to an increase in imports that augment more than exports, which are in any case volatile when consisting of natural resources. This may induce a worsening of the balance of trade and balance of payments, a rise in the trade deficit and hence real exchange rate devaluations (Santos-Paulino and Thirlwall 2002, Storm 2005). Moreover, as shown by Teal (2002) in the case of Ghana, trade liberalisation did not help to change the export structure nor the taxation structure, as these were based on commodities. Trade policy did not succeed in increasing export volumes, in moving towards sustainable growth: reforms did not address a source of failure, i.e. heavy taxation of agriculture, especially in the cocoa sector.

In the context of dependence on commodities and trade taxes, trade liberalisation has often reduced revenues, what has been coined as a ‘fiscal squeeze’. Trade liberalisation also had an indirect impact, such as unemployment and income effects stemming from investment decisions and shifts in competitiveness. The decrease in revenues may have resulted in a developmental vicious circle. Indeed, the capacity for conducting active public policies towards export diversification and export promotion, which entail costs for the budget, may be reduced. Declining revenues may have been accompanied by a rise in interest expenditure. Spending on infrastructure and maintenance, which is crucial for the building of the developmental state has often been the first category of spending that was reduced when governments were facing fiscal constraints, while other spending went to wages; other expenses, such as social spending, were financed by aid and debt. The payment of interest on the debt may have been an element of a vicious circle and underlying the squeeze, as shown by Khattry (2003).

Many low-income countries now have to increase revenue to provide finance for poverty reduction and are also confronted with other pressures on revenues, such as lowering corporate taxes and intensified international tax competition. The fiscal squeeze may be aggravated by another dimension of reforms, i.e. the rush to attract FDI. The offering to international investors of attractive tax exemption schemes is also an important factor that may prevent the building of developmental states. As shown by Hanson (2001), developing countries, especially the poorest ones, are facing a difficult trade-off between devising attractive tax schemes towards FDI and maintaining sustainable developmental fiscal capacities. As is well-known, Asian developmental states have been cautious in regard to openness to FDI, e.g., Korea, which valued the export oriented model, but has been careful about openness to foreign investment and ownership until the Asian crisis. Asian states indeed financed their development on occasion through risky banking games that exposed them to financial crises and structural fragility when they opened their economies under the pressure of the IFIs, which were compounded by local cronyism.

According to UNCTAD figures[67], the inward FDI stocks/GDP ratio was in 2004 for Hong Kong: 277.6%; Singapore: 150.2%, and for Korea: 10.7%. In SSA, FDI inflows represented 14.7% of the gross fixed capital formation, and FDI stocks 29.7% of GDP in 2004. In SSA FDI flows lag behind aid flows. For UNCTAD, SSA countries have opened their economies considerably during the adjustment period, and FDI is not limited by a problem of protection. The low level of FDI in SSA reflects its slow growth; the composition of FDI also reflects its productive and export structure, as most FDI is in the natural resources and mining sectors.

Trade liberalisation is beneficial for growth but is a costly process. Several studies have shown that trade liberalisation may imply a decline in revenue, especially in low-income countries. There seems to be some statistical evidence that reduced protection adversely affects overall tax and trade revenue, because the structure of low-income countries imposes strong constraints on

[67] UNCTAD (2005) on FDI in SSA, and for the evolution of figures, the annual *World Investment Report*.

the shift from trade taxes to domestic indirect taxes (Khattry and Rao 2002). In SSA countries, given the historical dependence of their revenue structure on external trade, trade liberalisation had the expected negative effects. As shown by Bevan (2000), in particular on the example of Kenya, it exacerbated fiscal difficulties and lead to larger deficits. This may generate vicious circles, in creating political difficulties for government and eroding the credibility of reforms.

A crucial issue is the possibility for revenue losses to be recouped from the domestic tax system, especially in strengthening domestic indirect taxes. For the IMF, it is by introducing or improving the VAT that countries can recover lost trade tax revenues. An IMF study by Baunsgaard and Keen (2005) shows that some countries have recovered from other sources the revenues they have lost from trade liberalisation. The problem is that it has been more the case for the high- and middle-income countries (for the latter, the recovery has been about 45-60% of the lost trade tax revenue). But it reveals that revenue recovery has been very weak in low-income countries, which are those most dependent on trade tax revenues (only about 30% of losses). Interestingly, despite the usual defence by the IMF of VAT, the study finds no evidence that in low-income countries the presence of a VAT helped to recover better than in countries that have no VAT.

For other IMF studies, such as Ebrill et al. (1999), the revenue implications of trade liberalisation are in fact uncertain. It is more accurate to observe that the net impact of trade reform on revenue is an empirical matter, that a range of outcomes is possible, depending on initial conditions and the components of the reform programme. For Ebrill et al., changes in a country's trade policy cannot be summarised and have to be assessed on a case by case basis, because they entail modifications in tariff structures and quantitative restrictions that are very complex, while their interactions with domestic taxes similarly exhibit high complexity.

For others, such as Michael Keen and Ligthart (2005), the negative relationship between trade liberalisation and revenue losses remain a major constraint in small economies; nevertheless, using modelling techniques they consider that it could be possible to overcome it with specific policies, such as combining tariff cuts with a one-for-one increase in consumption taxes or increases in consumption taxes so as to keep consumer prices neutral. The sequencing and implementation of these policies, however, appears to be very delicate. Above all, they show that if this would be beneficial in the abstract world of perfect competition, this type of policy may even lead to welfare losses in the real world, because low income countries are characterised by imperfect competition.

A negative relationship between trade liberalisation and revenues is not always found, however, including in other IMF studies. Some studies find that trade liberalisation is not strongly linked to aggregate tax revenue, and may even be linked to higher income tax revenue (this result is found with one measure, Agbeyegbe et al. 2004). Another study based on the example of Ghana found that the elimination of import and export taxes has been accompanied by an increase in VAT, suggesting effects on household poverty and income distribution (Bhasin and Kobina Annim 2005).

Finally, not only does trade liberalisation risk working in an opposite direction vis-à-vis revenue collection, but in addition it may entail risks of inconsistencies in reforms: there is indeed a possible tension between fiscal consolidation and trade liberalisation, as the latter may hinder the maintenance of industrial sectors. The latter are important precisely for keeping a minimal level of revenues as well as a diversification of sources of revenues (e.g., corporate taxes), in the context of significant informal sectors, large subsistence agricultural sectors, and widespread poverty that limit income taxes and which characterise SSA countries. Interestingly, it is expressed by possible divergences between the respective positions of the World Bank, which is a development bank, and the IMF, which has a mandate to guarantee the stability of the international financial system. The IMF is centred on fiscal balance and sustainability, and therefore on broadening the tax base and increasing levels and sources of revenues. In given countries the IMF may discuss measures of trade liberalisation that result in an excessive reduction in tax revenues. An instrument such as the elimination of exemptions may be insufficient[68].

There is no doubt that with the decline in trade tax revenues, trade liberalisation represents a new pressure on governments and intensifies the need to improve domestic tax systems, such as indirect tax system—including the VAT—and to reduce exemptions and rate differentiation. 'Transitional' revenue losses are a risk for the IMF, which insist on the careful sequencing of tax reform with trade liberalisation.

5. The effects of aid in terms of taxation and building the developmental state

The other crucial means of financing the developmental state is aid. A central question, however, is whether any developmental state can be built via external assistance. Aid has indeed made an historical contribution to developmental states. Asian developmental states benefited from assistance of the United States and Japan. Political motives have been determinant, in particular countering the expansion of communism. These political motives are difficult to disentangle from economic interests, as shown by the project of the Japanese imperialists to build a so-called 'area of co-prosperity'[69]. In traditional economic theory, foreign aid is necessary at early stages of growth, as it helps to finance the famous 'two gaps', i.e., the savings gap and the trade gap (or foreign exchange gap).

But economic theory also shows that the amount of aid is not enough and is constrained by the elements underscored by the first development theorists mentioned above, such as Paul Rosenstein-Rodan, Gunnar Myrdal, and others. At early stages of growth, what is needed is not only external financing but long term strategies for an efficient reallocation of factors and coordination devices. This means a key role for the state and its capacity to implement credible policies and reallocations. In addition, as shown by Easterly (2005) in his critique of the concepts of aid surges of the 'big push' type and of the concept of poverty traps, it seems that Asian countries grew slowly and gradually and without any 'big push' provided by aid.

The current aid system has evolved over the decades. Among other significant changes, there has been the shift to budget support instead of project aid and the set of reforms related to the PRSPs, i.e. directing the allocation of revenue to poverty reduction, and especially health and education. These changes in the aid system affect efforts at revenue collection. The policy changes occur in the context of heated controversy about the effectiveness of aid. If there is a broad consensus that 'aid works'[70], many important studies have recently expressed sceptical views and even dissent regarding the recent commitments of donors to increase aid (especially to SSA), with some economists such as William Easterly (2006) even viewing aid as harmful for development. Interestingly, these doubts about aid effectiveness have been expressed within the IMF as well. Rajan and Subramanian (2005a and b) thus found that aid has a negative relationship with growth, particularly in aid-dependent countries, as it contributes to the overvaluation of the exchange rate and hinders the competitiveness of recipient countries.

The fiscal effects of aid

There is now a preference within the donor community for programme aid, budget support, ex post assessments, and as claimed in the Paris Declaration in 2005, a focus on the improvement

[68] This tension has been examined in more detail for SSA in Sindzingre (2002).
[69] This controversial issue is examined in Kohli (1997, 1999), and Haggard et al. (1997).
[70] The literature is huge; a synthesis is in McGillivray et al. (2005).

in donor coherence and predictability of aid flows. There is, however, a well-known tension in the aid device, the tension between conditionality and ownership, which affects the feasibility of the new instruments. Moreover, it is not sure that these new types of aid imply real changes in terms of incentives for governments. As shown by Dixit (2000), the incentive mechanisms provided by conditionality (ex ante and based on action) and ownership (ex post and based on outcomes) respectively are not easily distinguishable; in reality they are a mixture and with agencies having poor observability of both actions and outcomes. New programmes may not induce significant changes in terms of taxation and better 'ownership' of it. Moreover, off-budget donor spending is still common in many SSA countries, which makes it difficult for governments to plan and make appropriate use of the measures of deficits. This is the case even if the PRSPs-PRGFs still choose to set a ceiling on the domestic fiscal deficit as a performance indicator[71].

As noticed by Moss and Subramanian (2005), if states rely on donors for finance, 'why bother to tax your own citizens'? There is no doubt that aid may provide incentives for reducing the tax effort. This is a classical risk that has long been highlighted in the economic literature: aid may crowd out rather than crowd in fiscal efforts, especially in aid-dependent countries such as in SSA. Aid may lower the incentives to broaden the tax bases and reduce aid dependency, though the latter constitute also other objectives for the donors. Aid therefore generates contradictory incentives and outcomes. Indeed, Azam et al. (1999) find via modelling techniques that aid dependence locks donors and recipients into a permanent situation of high aid and low institutional capacity and that aid is negatively associated with tax effort.

For Gupta et al. (2003), what matters for assessing the likely pressures on revenue effort is the composition of aid. The need to repay loans leads to increased domestic revenues, and concessional loans are associated with higher domestic revenue. Grants have the opposite effect: they are free resources that can substitute for domestic revenues and hence are more likely to reduce domestic efforts to collect more revenue. Foreign aid is thus non-linearly related to domestic revenue. Gupta et al. also show the importance of corruption, as the impact of aid is influenced by the level of corruption: the inflows of grants have a bigger, negative impact on revenues in countries with weak institutions.

This problem is a dimension of the more general issue of the fungibility of aid. As is well-known, a central feature of aid is that it is fungible and may therefore finance types of expenditure that were outside donors' objectives, such as recurrent expenditure. This has been shown by Njeru (2003) in the case of Kenya, where aid does not seem to diminish fiscal efforts, but fungibility allows the government to use it for financing recurrent expenditures. The issue of fungibility underscores a key difference between aid as a device for building a developmental state, as in Asia, and the functioning of aid in the poorest countries: because of a context of a combination of aid dependence and aid fungibility, aid volatility has detrimental effects on government revenues and on the consolidation of state capacity.

An additional problem is debt. The fact that aid includes loans generating debt combines with aid fungibility and programs prescribing allocation to poverty reduction and social sectors. There is an ongoing debate as to whether loans or grants would be the optimal means of providing aid. The key issue is in fact whether these projects have the level of returns that would not aggravate fiscal deficits. However, aid finances through grants projects that have high social value but uncertain returns, in particular education and health. The other projects that are financed via loans must have high returns, e.g. infrastructure, if fiscal deficits are to be avoided. In this context, budget support creates new problems, as the government is supposed to decide its priorities and may not necessarily take the decisions that bring about the appropriate returns. These difficulties are aggravated by the fact that aid is fungible, and that PRSPs focus on

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[71] See Bigsten and Lundström (2004) on the case of Rwanda.

poverty reduction, health and education, which may lead to deficits, unless financing is achieved through grants (Daseking and Joshi 2005).

In contrast, some studies do not find this negative fiscal effect of aid, as is the case in Ghana, if governments implement sound policies and make a wise use of aid in the fiscal domain. Analysing the effects of aid in Ghana over more than three decades, Osei et al. (2005) reveal that aid there has been associated with reduced domestic borrowing and increased tax effort, resulting in an increase in public spending and a maintenance of the fiscal balance; and hence that a 'constructive' fiscal use of aid is possible.

The fiscal impact of aid may also vary according to the type of tax: McGillivray and Morrissey (2001) recommend a lesser focus on problems of fungibility and composition of government spending. Their review of the literature shows mixed and complex results and that require fine distinctions, e.g. between the impact of aid on total tax revenue and the impact of aid on revenue from international trade taxes. Their analysis of various fiscal response models reveals that aid may discourage tax efforts or encourage increased borrowing, but also that aid may increase tax efforts, encourage increased spending on investment, and support improved fiscal management so reducing borrowing. These mixed results are confirmed by Gupta et al. (2005), who review 16 studies of the effect of aid on domestic revenue in developing countries (relying on McGillivray and Morrissey 2001): only 6 studies find a positive effect of aid on domestic revenue collection[72].

The IMF remains cautious towards aid and particularly the aid increases that have been promised for SSA, in a discrete contrast with the rest of the donor community. As analysed by Gupta et al (2005), the empirical evidence on how aid flows affect domestic revenue collection is mixed, but often negative. The IMF warns that the scaling up of aid has an important impact on revenue mobilisation and efforts, as governments may view aid as substitutes for domestic revenues. The IMF is aware that the weaker tax effort can have an adverse effect on domestic institutions: citizens will not hold the government accountable when they pay lower taxes (Bevan 2005). If aid inflows are temporary, additional problems occur, e.g., the fact that aid is volatile and unpredictable. This is why the IMF put the emphasis on broadening the tax base with the objective of reducing aid dependency over time.

Aid dependence as an obstacle to the developmental state

Low-income countries are characterised by aid dependence, in contrast with developmental states. A feature of Asian developmental states is that they tried to avoid a prolonged use of foreign aid and technical assistance (Brautigam 1995). In low-income countries, aid is the major source of external finance since the 1970s. Between 1970-75 and 1991–95, aid as a share of GDP in low-income countries increased from 6% to almost 15%. During the same period, private capital inflows (including FDI) fell from 2 to 1 % of GDP (Morrissey 2004). Aid dependence ratios may be much higher for particular countries. Many low-income countries' central government expenditures depend on aid for more than 50%, and some countries are almost entirely dependent on aid for gross capital formation, as it appears in the World Development Indicators (2005), which note the increase of the aid dependence ratio in SSA since the 1980s.

Aid dependency has several negative effects, which are now well identified in the literature: in particular, volatility, unpredictability of aid flows, problems of capacity of absorption. These were analysed with particular care by the IMF for the five SSA countries that received more than one billion US$ of aid inflows[73]. Volatility and unpredictability have been demonstrated by

[72] Gupta et al. (2005, table A4): 5 studies find no effect.
[73] Ghana, Tanzania, Ethiopia, Mozambique, Uganda.

well-known studies by Bulir and Hamann (2001, 2003, 2005), which show that the volatility of aid is much higher than that of revenue and that the relative volatility of aid increased in the late 1990s. The average volatility of aid is about 40 and 20 times higher, respectively, than that of revenue when expressed in percent of GDP and constant U.S. dollars per capita. Using medians, the respective estimates of the relative volatility of aid are 23 and 6. They reveal that the relative volatility of aid is the highest in the sub-samples of the least and most aid-dependent countries, defined as having aid-to-revenue ratios of less than 25% and more than 50% respectively. Interestingly, Bulir and Hamann notice that if using medians, the average volatility of aid appears to decline with the increase of the aid-to-revenue ratio. Aid is not only volatile but also unpredictable: they calculate that, on average, aid delivery falls short of pledges by more than 40%, especially for the poorest countries. Some studies, however, consider that it is possible to devise instruments for offsetting these aspects of aid, which are similar to classical instruments coping with price volatility, e.g. via saving and spending rules built around buffer reserve funds based on a given number of months of import cover, which can buffer public spending against short-run fluctuations in aid disbursements (Eifert and Gelb 2005).

Aid dependency may be accentuated by the programmes of poverty reduction. As shown by the IMF (IMF 2005), higher spending in social sectors raises the ratio of government spending to GDP: e.g., HIV/AIDS disbursements in a series of SSA countries in 2005 reveal that total potential funding amounts to 3% of GDP in Uganda, about 2% in Ethiopia, and 1% in Mozambique and Tanzania, which contributes to the crucial question of the sustainability and reliability of aid flows. The new ‘paradigms’ of aid such as budget support do not eliminate aid dependency and the associated problems of volatility and burden on local civil services[74].

The goals of poverty reduction of the IFIs and the other donors, and the surge in aid that is associated with them, entail risks for the prospects of building developmental states in SSA, which would take into account their fiscal dimensions. Interestingly, the positions of the IMF here are not entirely similar to those of the World Bank. The IMF aims by mandate at moderating aid inflows, limiting primary deficits, focusing on increasing taxation, and curbing aid dependency, as was recently shown by the case of Mozambique. The IMF does not necessarily agree with the other donors, the Bank and the bilaterals, which tend to be generous with countries that may have favourable prospects, paying less attention to the real capacities of absorption of the recipient country. It may therefore happen that grants or loans cannot be absorbed and spent by the recipient government, which may be compounded by institutional and political factors, such as the fragmentation of administrations by aid projects, political rivalries or absence of vision and planning in the long term. The World Bank is a development bank with a different mandate from that of the IMF. It may therefore support aid inflows as long as they are in line with GDP growth[75].

Whatever its form, projects or programmes, some problems seem inherent with aid: the fact it is external and with a multiplicity of players generates non cooperative games. Harmonisation thus seems inherently difficult. Adjustment, stabilisation programmes and then PRSPs attempted to mainstream the framework of public expenditure, now achieved through the Medium-Term Expenditure Framework (MTEFs) and public expenditure management (PEM). As underscored in a World Bank study (Obidegwu 2005, which draws on the example of Rwanda), MTEFs explicitly resulted from a series of assessments: the deterioration of budget institutions and performance in SSA, and the responsibility of aid as a major part of budget financing in the fragmentation of the budget and the distortion of budget priorities. They aim at a better integration of budgets in order to put an end to their fragmentation, and incite donors to harmonise their procedures and align to the MTEF and the budget process. In the countries that adopted MTEFs, however, the results have been mixed.

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[74] See the study by Lawson et al. (2005) of the limitations of general budget support on the case of Tanzania.
[75] Alex Warren, personal communication, March 2005, made this important point.

More worrying for the construction of developmental states, aid dependence also contributes to the weakening of institutions. It weakens the credibility of governments and of their policies, and therefore weakens political institutions and their legitimacy. Strategic decisions are perceived as taken outside the country and situated outside the capacity of the government. Governments are accountable towards external donors, not toward domestic parliaments and constituencies, as policies are evaluated by these donors. Aid here may hinder the formation of the institutions of the developmental state. Aid has negative effects in terms of their key ingredients, i.e. the formation of coalitions between the state, the private sector and civil society, the consolidation of institutions and policy credibility.

Moss et al. (2006) show that the large increases in foreign aid to SSA that are the central agenda of the international community may have negative effects not only on state revenue but also on state institutions, especially political institutions. In particular, aid dependence transforms the relationship between the state and its citizens: if governments raise their revenues from foreign aid a risky outcome is that they become more accountable to donors than to their citizens. They do not have to build legitimacy nor devise credible policies and effective institutions, as it is vis-à-vis donors that they have to be credible. Aid may therefore work against the building of the development state.

The crucial question remains the identification of the ingredients of credibility and commitment of a government, and of a right composition of policies, which are credible, politically feasible and effective in terms of growth. A related question is whether external assistance can have a role, and in this case, whether it may expect foreseeable outcomes, if these processes are mostly endogenous.

If, as suggested in a FIAS-DFID study (FIAS 2006), possible objectives could be the conditions of building a ‘fiscal contract’ between the state and the taxpayer, for being a genuine contract it would require endogenous rules of the game that are mutually agreed between the two players. Third parties such as donors here introduce additional complexity, i.e. additional games for the state and the taxpayers. Such a ‘fiscal contract’ would also require clear rules and credible threats and enforcement. These are indeed the conditions of building a developmental state.

Conclusion

This paper has focused on the concept of the developmental state, the conditions of its consolidation, especially in the perspective of the modes of financing it would require. The issues of taxation, public revenue and spending, have been examined in detail, because they constitute crucial elements in the building of viable developmental states, and are notoriously problematic in least developed countries, especially in Sub-Saharan Africa. The concept of the developmental state stems from studies of the fast-growing East Asian economies in the late eighties, and this is why the paper has examined their main features as developmental states.

The elements of the developmental state have been presented, and especially the fact that they rely on low levels of taxation and public spending, at least at the early stages of their development. The principal elements and constraints regarding taxation in Sub-Saharan Africa have been analysed, in particular its dependence on commodities and external trade, as well as the effects of IFI programmes, in particular trade liberalisation. These effects appear to be highly complex and mixed, as is their contribution to enhanced conditions for developmental states in Sub-Saharan Africa. The constraints that affect aid in the building of effective and developmental taxation systems and states have also been examined. The impact of aid appears to be particularly complex, not only because of its volatility and unpredictability, but because aid provides incentives that may undermine tax structures and key state institutions of recipient countries, such as policy credibility and political legitimacy.

Two arguments have thus been explored. Firstly, the lessons of Asian developmental states show that the capacity for a state to credibly commit and intervene is a crucial feature, but above all under the form of policies that are directed towards growth, and not policies that recycle the national wealth through taxation and large transfers between social groups. These states suggested a series of ingredients: intervention of the state in the economy via credible policies oriented towards growth, capacity to address coordination failures and to reallocate factors of production, flexibility, coalitions between the state, private firms and the civil society. These ingredients cannot be disentangled from political dimensions, growth having being instrumental in the building of legitimacy and political support. Secondly, it has been argued that for a policy or an institution to be effective, it needs to be credible and perceived as a commitment, which results from endogenous processes. These conditions for developmental states and institutions are currently missing in most Sub-Saharan African countries.

The paper concludes in highlighting a difficult question: can external players such as IFIs programmes and foreign aid, given the intrinsic asymmetry of conditionalities, given their objectives and procedures, given contexts such as aid dependence and tight budget constraints, contribute to the building of effective institutions, policies and commitments towards growth. Creating a 'fiscal contract' that would be more developmental involves both political and economic processes that result endogenously and over time from the interactions between governments and their citizens. The many constraints examined in the paper show that rather than a direct impact, donors can only create the conditions for these developmental processes to emerge.

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