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The Politics of Taxation

> The spirit of a people, its cultural level, its social structure, the deeds its policy may prepare – all this and more is written in its fiscal history, stripped of all phrases . . . The public finances are one of the best starting points for an investigation of society, especially though not exclusively of its political life.
>
> — Joseph Schumpeter[1]

When former exiles Nelson Mandela and Fernando Henrique Cardoso were elected as presidents of South Africa and Brazil in 1994, the poor and largely black majorities in both countries had good reason to be hopeful. Both men had been outspoken critics of prior authoritarian regimes, socioeconomic inequality, and persistent racial discrimination in their respective countries. Democratic transitions, which paved the way for these men to take the helm of government, provided unique opportunities to steer state policy on a new course. It finally appeared as though the plight of the poor and previously disenfranchised could be improved in what had become the first and second most unequal societies on Earth.[2]

Yet, these new presidents soon discovered that they had inherited very different *states*, with different capacities to govern, and in particular, to collect taxes. The South African state emerged as one of the most effective collectors of income tax in the world, and was able to collect approximately 15 percent of its gross domestic product (GDP) in the form of progressive, direct income taxes. Meanwhile, the Brazilian state could barely collect

[1] Schumpeter 1954: 7.

[2] As measured by the GINI coefficient, according to World Bank (1996): 197 rankings. Brazil's GINI coefficient was 63.4 in 1989 and South Africa's was 58.4 in 1993.

5 percent of GDP of such revenues. Instead, Brazilians were paying a wide range of complicated, hidden, and typically regressive taxes, levies, and other charges that are largely not present in South Africa. Moreover, it cost the Brazilian bureaucracy approximately three times as much as its South African counterpart to collect revenues.[3] The wealthy minority in South Africa was largely complying with the state's demands for taxes, while the wealthy minority in Brazil deployed a vast set of tools to avoid and to evade payment. Given the extraordinary concentration of income in these two countries, the associated impact of these different patterns of compliance on the fiscal health of the state has been dramatic: In the wake of the Asian currency crisis of 1997, the Brazilian government announced a multi-billion-dollar bailout from the International Monetary Fund (IMF) while the South African government reported better-than-expected collections of taxes, and did not require interventions from any international organizations. In an essay relating class struggle to democratization and state power, Rudolph Goldscheid prophesized, "The masses which eventually acquired greater power in the State saw themselves cheated of their prize when they got not the rich State but the poor one."[4] Indeed, this was the case for Brazil, but not South Africa.

Important differences in the tax systems and tax structures of these two transitional societies were largely legacies from the countries' respective predemocratic pasts. Yet, such outcomes are surprising when one considers the reputation of the South African state as historically allocating resources in a *regressive* manner, and the reputation of the Brazilian central state as exceptionally large and influential over significant levels of resources. Ironically, the tax burden was much heavier on the poor and on blacks in Brazil than it was in South Africa, where the wealthy, white population continued to pay most of the tax bill. Mandela's government, with one of the most progressive tax systems in the world, enjoyed greater effective authority with respect to the privileged minority than Cardoso's government in Brazil. This book attempts to explain this conundrum.

Questions about the determinants of national tax structures, and of state capacity more generally, are longstanding questions, but standard social scientific explanations do not provide an obvious answer for why the Brazilian and South African states extract tax revenue in such different ways. Purely structural explanations – which relate the influence of economic and/or

[3] Cost of collections as share of total collections.
[4] Goldscheid 1964: 205.

international influences to the development of taxation systems – are clearly incomplete, as these factors have been extremely similar across the two countries during the course of the 20th century. Both countries pursued similar development strategies in the 20th century, mainly through protected industrialization, and both enjoyed periods of extremely rapid economic growth in the post-War period. Levels of economic development have been very similar, and by the mid-1990s, per capita income was $2,970 in Brazil and $3,040 in South Africa.[5] In both countries, the state is relatively large, and total government expenditure is about the same (about 32 percent of GDP in the 1990s). Explanations emphasizing the role of political regimes are not very helpful because both countries share histories of long authoritarian pasts with recent democratic transitions. Cultural explanations have tended to be largely tautological, "explaining" varied tax outcomes in terms of different tax "cultures." Moreover, both societies are comprised of a wide mix of racial and ethnic groups; both were colonies of European countries; they share legacies of European immigration and slavery; and in both, racial characteristics continue to be highly correlated with income and wealth. Even more technical arguments, relating tax structures to levels of professionalism in the tax administration, do not stand up to careful empirical analysis – there is no evidence to suggest that the South African bureaucracy is either better trained or more technologically sophisticated than the Brazilian bureaucracy.

As an alternative, this book provides a political-institutional explanation highlighting the importance of foundational moments when notions of "us" and "them" get socially constructed, shaping the logic and trajectory of political competition for long periods of time. It argues that patterns of inter- and intra-class cohesion are critical to the ways in which the free rider problem of taxation gets resolved. Although such class relations get put in place during the process of economic change, economic factors alone do not determine those relations. An explanation must include the historically constructed definitions of National Political Community (NPC) – the group of people officially entitled to the rights and responsibilities of citizenship. Definitions vary in terms of how racial, ethnic, and regional identities get configured, and in what ways certain groups are included or excluded (i.e., with racial or nonracial definitions of citizenship; as federations or as unitary states). Such definitions have an important influence on

[5] World Bank 1998.

the strength of class unity and cross-class relations. In turn, such relations shape the context and strategies of citizen behavior, which ultimately affects the types of tax policies that get adopted and the ways in which they are implemented.

Different definitions of NPC are responsible for the divergent legacies of state revenue production evident in the South African and Brazilian states during the contemporary period of democratic transition. Looking back to the turn of the 20th century, this book argues that the construction of a racial union in South Africa led to high levels of inter- and intra-class solidarity, which in turn motivated upper groups to pay, whereas an officially nonracial federation in Brazil led to inter-class polarization, intra-class fragmentation, and, ultimately, resistance to tax payment.

The political glue of race, or "whiteness," helped the South African state to solve the collective action problem of taxation among the upper groups controlling private economic resources by providing a clear idiom that emphasized strategic and normative obligations to one another and to "poor whites" within that society. During key historical moments during the 20th century, the political salience of race in South Africa implied that social and economic policy should help to uplift all whites in ways that they would not "sink" to the level of blacks or "natives." By contrast, in Brazil, a different strategy was implemented to address the race question. *Official* discrimination was made illegal, and poor whites have been treated simply as "poor," rather than as "white." Nevertheless, racial stereotyping and prejudice were perpetuated in Brazil with the government's deliberate attempts to "whiten" the population through racial mixing, immigration, and other policies.[6] In such a political environment, race-based class solidarity was unavailable, and inequalities within and between race groups were tolerated as part of a more "acceptable" socioeconomic hierarchy.

Moreover, the political salience of regions, stemming from Brazilian federalism, exacerbated the problem of taxation, dividing upper groups from one another and impeding the ability of the poor majority to make national, class-based demands for progressive taxation. The flame of regional competition in Brazil gained fuel from an underlying perception of different racial demographics between North and South that could not be articulated explicitly within the discourse of race politics. By contrast, in South Africa, the formation of a union – as opposed to the federation that most

[6] Skidmore 1995.

had expected – helped to smooth over regional divides within the white polity. The physical boundaries of the country were defined in racial terms – in which a small portion of the land was reserved for the black majority – strengthening the sense of solidarity and willingness to pay among the white minority. White workers organized themselves on a national scale, unfettered by the regional divisions found in Brazil, and acted to maintain political pressure for the expansion of progressive taxation.

In short, definitions of NPC shaped the development of tax policies and administrative patterns – a combination of outcomes that I refer to as the *tax state*[7] – and the legacy of the respective state-building processes continues to account for wide cross-national differences in levels and structures of tax collection. The remainder of this and the following chapters provide a more general theoretical framework and substantial evidence to support this argument. This analysis begins by discussing why the question of explaining variation in taxation systems is worth asking in the first place. Second, it specifies a relatively general, institutional argument, the *Political Community Model* of tax state development. Third, it identifies a set of possible alternative explanations for variation in the state's ability to tax. Finally, it provides an overview of the methodology for assessing the explanatory power of these models, and it describes the organization of the book.

The Problem in Perspective

This study of the politics of taxation in Brazil and South Africa addresses questions relevant to students of comparative politics, economic development, state-building, and identity politics. In fact, this book is likely to be of *least* interest to those interested in the minute details of tax policy and tax administration, because such details are not the focus here. Rather, the central objective is to take up Joseph Schumpeter's charge to use taxation as a lens onto broader social and political problems. For readers already familiar with the political and economic histories of Brazil or South Africa – and even the tax systems of the respective countries – this book provides a framework for understanding each of these cases in a comparative context. However, the book does not assume that readers are familiar with the political or economic histories of either of these two countries, particularly of their tax systems. By investigating the politics of taxation in Brazil and

[7] A term generally associated with Schumpeter's work. In Chapter 2, I provide a more precise analytic definition.

South Africa, this text sheds light on many of the poorly understood dynamics of politics and policy-making relevant to other countries, including the United States.

Why a Study of Taxation?

A comparative study of the history of taxation provides insights into the development of modern state capacities to wield their authority over individuals and groups within society. The ability to tax is virtually a prerequisite for governance. Douglass North goes so far as to include taxation as central in his definition of the state: "... an organization with a comparative advantage in violence, extending over a geographic area whose boundaries are determined by its power to tax constituents."[8]

The power of states to tax varies widely across countries. Since the earliest times, collection has always provided a difficult challenge for political leaders. Throughout the history of modern governments, citizens have complained about the burden of taxation. Yet, despite the similarity of their words and claims – that taxes are "too high" or "unfair" – citizens have responded in quite different ways to demands for payment. In some societies, including those in which public rancor over taxes seems constant, many individuals not only pay more than half their annual income to the state in the form of taxes, but they spend substantial amounts of time keeping records of their income and expenses in order to comply relatively faithfully with various tax laws and policies.[9] In other societies, the state's demand for tax payment falls on deaf ears. Even individuals with substantial means manage to resist payment of virtually any tax. Either they influence the writing of the tax laws in such ways that they are able to legally escape tax liabilities, or citizens actively find ways to evade their legal burdens. In the wake of such differing citizen responses to the demand for taxes, levels and structures of collections vary widely across countries.

As will be discussed in greater detail in Chapter 2, we can observe qualitative and quantitative differences in national patterns of taxation. States that regularly collect from a wide range of societal actors are generally also able to govern effectively in a range of other areas, while the inability of a state to generate significant revenue through taxation is often a precursor to state failure or even collapse. As new states seem to be sprouting up

[8] North 1981: 21.
[9] Peters 1991.

around the globe on a regular basis, the need to understand the process of state development – and the development of capacities to collect taxes in particular – could not be more pressing.

By focusing on the development of modern state capacities to tax economically "privileged" groups within society, this book attempts to understand the origins of varied taxation regimes and to resolve longstanding questions about the relationship between state and capital. During the 20th century, leaders of most modern states paid lip service to the notion that tax systems should be fair, advocating that those with greater economic means ought to pay a relatively larger share of the tax burden. Particularly in societies in which income and wealth are concentrated in the hands of a relatively small minority of people, the state's ability to tax this group is particularly relevant. Although a wide range of scholars, from Karl Marx to Charles Lindblom, have noted that upper groups tend to occupy a privileged position with respect to state authority, the law-like characterization of this relationship is at odds with the observation that the relationship between these two groups varies so widely across countries such as Brazil and South Africa.[10] While the state does collect quite a bit of tax revenue in both countries, the relationship between the state and upper groups in Brazil is *adversarial*, whereas the analogous relationships embedded in the South African "tax state" are *cooperative*.

An investigation of taxation must be central for students interested in the political economy of development, poverty, and inequality. In the contemporary world of declining foreign aid, tight credit, and a policy orthodoxy against state ownership of enterprises, modern states largely depend upon tax revenues to finance security and welfare functions. Clean water, education, roads, health care, police, national defense, and all of the other goods and services states provide are largely financed through taxation systems. Moreover, the operations of a national tax system influence the distribution of income, the functioning of markets, and the nature of investment. As a result, the question of taxation is particularly relevant for developing countries, in which taxation capacities tend to be quite fragile. The implications of differences in capacities to collect taxes has serious multiplier effects on the ability of those states to finance their expenditures, because creditworthiness on international financial markets is often determined by such collections and their relationship to the size of national budget deficits.

[10] For a review of these arguments, see Przeworski and Wallerstein 1988.

Despite the substantive and theoretical relevance of such concerns, the politics and practice of taxation in this set of countries have been remarkably understudied.

Finally, a study of the development of the tax state provides an opportunity to investigate the roots of collective action and cooperation. The central dilemmas of collective life are embodied in the question of taxation. The state's demand for such revenues from society implies the thorny questions of *who* should pay, and *how much?* Because the demands for public goods and the incentive to free ride on the payment of others are both great, "taxation inherently implies politics."[11] Nonetheless, a surprising amount of revenue is collected by states in the form of taxes, amounting to more than one-fifth of global economic production in recent years. In 1994, middle-income countries collected $630 billion in tax revenues.[12] Few people would disagree that politics and taxation are intimately related, but the task of specifying the relationship between the two – particularly when considering broad patterns of cross-national variation – remains incomplete.

Why Brazil and South Africa?

This book is concerned with general questions pertaining to the development of national tax systems, but it is focused on taxation in Brazil and South Africa. Both substantive and analytic concerns motivate this two-country comparison.[13] The vast array of social, political, and economic similarities between the two countries described above provides something of a "natural experiment" which is rare in cross-national social science research. In order to explore the argument that variations in the salience of particular identities influence the development of tax policy and tax administration, it is most useful to compare countries in which there is significant *variation* on this score. Brazil and South Africa, as will be argued much more fully below, developed extremely different approaches to racial and regional cleavages, and it is this high degree of variation that allows us to assess the impact of

[11] Bates 1989: 479.

[12] World Bank 1998.

[13] Others have usefully made quite explicit comparisons between Brazil and South Africa, reinforcing the notion that these are comparable cases. See, for example, Marx 1998; Seidman 1994; and Friedman and de Villiers 1996. Moreover, studies of Brazilian race relations have tended to employ the South African example as a point of reference. See, for example, Andrews 1991.

this factor on other outcomes, particularly in the wake of various analytical controls. A single country study would provide far less analytic leverage.

Second, although Brazil and particularly South Africa often appear unique in terms of certain aspects of their political and economic histories, these cases generate a series of insights about the political economy of state development. In grappling with questions about nationhood and the problems of racial and regional heterogeneity, these societies have many analogs, including, but not limited to, the United States. Indeed, these are extreme cases in terms of how definitions of NPC have been specified, but in a paired comparison, such contrast provides the most analytic leverage for assessing the impact of definitions of NPC on taxation outcomes. The book draws on broad cross-national comparisons in order to make inferences to a much broader population of country cases. Where variation in definitions of NPC is less extreme, we should expect less extreme variation on the outcome, but the same causal forces may be at work.

Finally, because of the great inequalities in both societies, and because of the fragile nature of these new democracies, the factors that influence tax collections and the development of state authority are materially relevant in the near term. If the clear and transparent operation of a taxation system is important for economic growth and development, as most development analysts argue, then the stability of these fragile democracies is at least partially dependent upon the outcome of the questions considered here. In an increasingly integrated international economy, the fiscal health of these two economies – the largest in the sub-Saharan African and Latin American regions – affects financial conditions around the world.

The Argument

Having established the puzzle of variation in the types of tax states developed in Brazil and South Africa, and having justified why this puzzle should be of interest, the remainder of this chapter develops more fully an explanation of these outcomes. Three key factors – economic structure, the international environment, and historically rooted institutions that define the NPC – provide the basis for a robust explanation of cross-national variation in taxation structures, particularly in terms of the state's ability to tax upper groups within society. This book focuses on measuring the impact of institutional definitions of NPC, demonstrating the limits of the other two factors on their own to account for important variations across time and space. While changes in the mode of production; variations in the timing of development; and international ideas, conflicts, and structures all affect taxation outcomes, historically rooted institutions, which give political salience to certain group identities and not others, mediate those pressures into specific sets of class configurations and coalitions that lead to distinctive types of tax states.

Economic and International Influences

As scholars from a range of theoretical perspectives have argued, the processes of economic development and modernization have been central to the development of taxation systems.[14] Depending upon the theoretical orientation, the hypothesized relationship between these factors varies widely across these studies, but they commonly recognize the correlation between the process of modernization and the development of taxation systems within and across countries. Economic development is generally associated with the concentration and specialization of production, which leads to increased demands for publicly provided goods and services, in turn making tax collection easier because citizens can be convinced of the state's need for financial resources. More industrialized economies have tended to generate not just more tax revenue in an absolute sense, but even relative to the size of their economies. Moreover, the state's reliance on direct income taxation has also tended to increase with level of economic development. Such observations led earlier analysts, enchanted with the tenets of modernization theory, to predict that countries would follow a common path of development of taxation capacity, and would eventually collect a greater share of income tax revenues.[15]

In particular, during the process of economic development, business leaders and high-income individuals tend to enjoy increased economic returns on investment, and they become more willing to pay taxes to a government that will act to protect their property. Of course, one would imagine that there are certainly upper bounds to the extent to which levels of economic development positively influences the relationship between the state and upper groups, but when comparing wealthy countries to poor ones, it is relatively easy to understand the increased willingness of privileged groups in wealthier societies to cooperate with the state's efforts

[14] Tanzi 1987; Peters 1991; and Levi 1988.
[15] Hinrichs 1966.

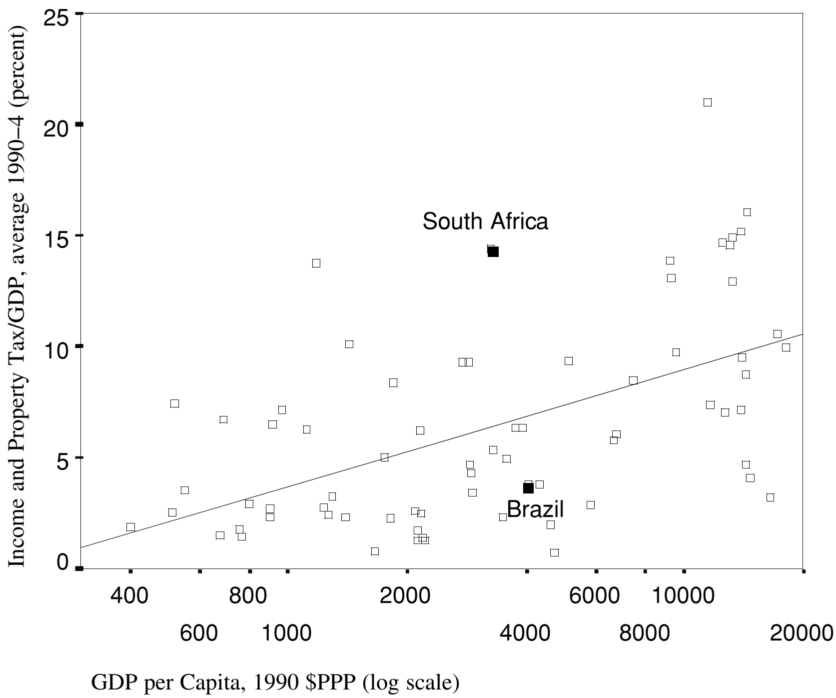

Figure 1.1 National income and property tax collections as a function of GDP/capita, 1990–1994. *Source:* World Bank 1998.

to collect taxes. Within poorer economies, not only will upper groups with private sources of income and wealth have less to protect, but they will have less reason to believe that the state will be able to serve their needs.

Indeed, cross-national comparisons reveal a strong correlation between level of economic development and tax collections. For example, looking at income and property tax collections for the period 1990–94, it is clear that there is a strong and statistically significant (Pearson's $R = .56$) relationship between collections and GDP per capita (in purchasing power parity units), as demonstrated in Figure 1.1. Nonetheless, the scattering of countries both above and below the best-fit line implies that there is room for other explanations and that other factors may affect levels of collections. The contrast between Brazil and South Africa is particularly striking – as South Africa is way above the best-fit line and Brazil is significantly below.

Beyond domestic economic factors, scholars have also emphasized the role of international influences on the development of tax systems.[16] Wars, foreign models of policy and/or administration, participation in the state system and international organizations, and new trade regimes are among the many factors that influence domestic policies and practices. Specifically, major wars have tended to inspire upper groups to see beyond narrow self-interests and to cooperate with the state by consenting to heavier tax burdens. In the absence of threatening events such as wars, upper groups are more likely to challenge demands for revenue. Moreover, international trends in the degree to which the state collects from upper groups tend to influence the development of any given tax state by providing important political and technical ammunition for actors within society to advocate for prevailing norms.

It is relatively easy to show that national patterns of tax policy and tax collection are strongly influenced by a set of common factors, including demonstration effects, and that international trends are temporally marked by particular years and/or events, demonstrating the importance of factors that transcend national borders. As will be discussed more below, shocks tend to have a long-term ratchet effect on tax collection. Yet again, we find that even countries such as Brazil and South Africa, which have played broadly similar roles in the international political economy, and have been influenced by relatively similar international factors, have developed very different types of tax states, suggesting the need for a fuller account.

National Political Community

While it is true that both economic and international factors have influenced the development of tax systems, the impact has been far from uniform. In fact, in the face of similar albeit changing international and economic pressures, state capacities to govern and to collect taxes have not converged but have diverged during the past century. Many scholars have been puzzled by the great variations in policy instruments and administrative practices employed across countries, and have relegated important "residual" variation to a political "black box." As one economist explained in an essay on taxation systems in developing countries, "Although political constraints are clearly important, most economists feel uneasy about taking them into account.

[16] See, for example, Weber 1968; Goldscheid 1964; Tilly 1975; Steinmo 1993; Levi 1988; and Kiser and Linton 2001. For a discussion of the influence of "emergencies" on the development of the American tax system, see Brownlee 1996.

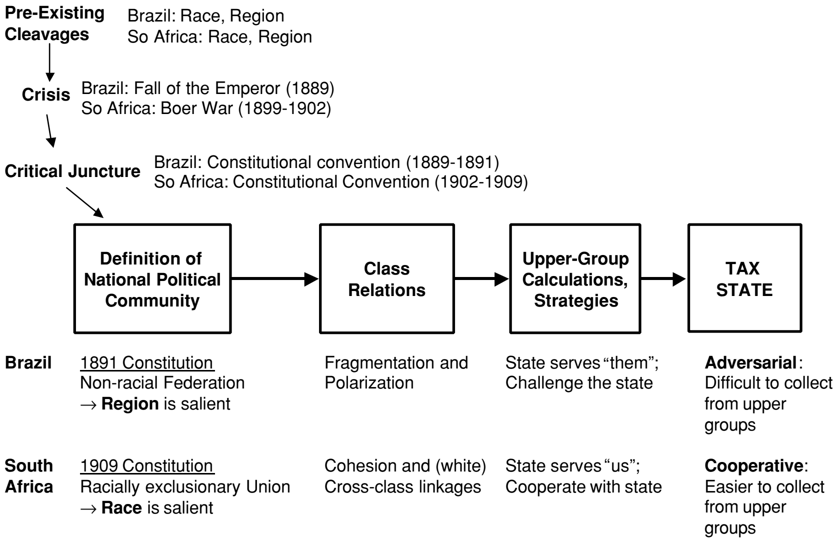

Figure 1.2 The political community model of tax state development.

Part of the reason is that they are not well understood – by economists, at least."[17]

The political community model of tax state development (see Figure 1.2) highlights the transformative role of mobilized political identities in shaping the development of the state. It is a *critical junctures* model that relates the definition of the NPC, or the formal criteria for citizenship, to the development of the tax state. The most prominent characteristics of the NPC are defined during a comparable "period of significant change, which occurs in distinct ways in different countries . . . and which is hypothesized to produce distinct legacies."[18] These critical junctures follow crisis periods of major social, political, and economic upheaval, such as social revolutions, wars, and other serious breakdowns of the normal political order. In response to such crises, political elites may debate and negotiate for their preferred specification of who should be included and who excluded from membership. In this model, the critical juncture of interest is the historical period during which a wide range of possible definitions of NPC are considered as serious alternatives and possibilities by national political

[17] Newbery 1987: 198.
[18] Collier and Collier 1991: 29.

elites, and concludes when a definition is ultimately specified in crucial legal documents, typically including the constitution, various laws, and national policies. In particular, this book focuses on two sets of alternatives in specifying the definition of the NPC in response to pre-existing racial and regional cleavages: whether or not to adopt federalism, and whether or not to continue excluding blacks from full and equal citizenship. The definition of the NPC tends to be reinforced through other important documents and symbols, including the media, museums, the census, and maps.[19]

Subsequently, the distinguishing characteristics of the critical juncture – that is, the different ways in which the NPC gets defined – tend to cast a long shadow on the future, even once the initial conditions have changed.[20] The institutions that remain and endure set in motion path-dependent processes of state development.[21] Depending upon how the NPC gets defined, certain identities, including racial, religious, ethnic, or regional identities, are more likely to become politically salient than others.[22] When the definition of NPC explicitly provides special protections or powers for certain groups, it is much more likely that such groups will become politically salient. The specification of group rights in the form of official state documents and policies provides a strong set of incentives for political entrepreneurs to make claims based on such identities. Alternatively, when particular identities or cleavages are ignored in the definition of the NPC, they are much less likely to be mobilized in the political arena. While the state's influence on identity formation is neither determinative nor exclusive (other factors may shape which groups mobilize and on what basis), it is certainly powerful. Federalism, for example, tends to give important political salience to regional identities, and official racial exclusion tends to give much greater salience to racial identities than in other countries characterized by racial heterogeneity, but with more liberal policies toward race.

[19] For discussions of the concept of the nation, and how national identities are articulated within societies, see especially Anderson 1996; and Haas 1986. These ideas are elaborated more fully in Chapter 3.

[20] Goldstone 1998: 842–3.

[21] See Thelen 1999; Pierson and Skocpol 1999; Pierson 2000; Skocpol 1984; and Mahoney 1999, for discussions and examples of path dependency. The paradigmatic example of this work is Moore 1966.

[22] As Laitin (1986: 19) points out, a society may contain multiple cultural or other identities, but only certain identities emerge as relevant for *politics*.

Class Relations

The mobilization of group identities structures the quality of inter- and intra-class relations, which are central to the strategic environment in which societal actors make decisions about cooperation and compliance with the state's demand for tax payment. Because I do not assume that identities are merely reflections of economic resources within society, upper-income groups will either be *cohesive* because they share common political identities or they will be *fragmented* because they are divided by particular political identities. Moreover, upper groups may share group identities with lower-income groups that can be the strong basis for cross-class linkages. If they do not share such identities, they are more likely to be polarized, separated by differences in material interests *and* group identity.

A critical manifestation of these class relations develops in the form of organizations, which serve as actors in political interactions with the state. That is, upper groups may become either united or divided by the main business organizations, political parties, and government institutions that tend to aggregate interests within a society.[23] Their relationship to lower groups is largely influenced by the quality of labor organizations and the ways in which labor gets incorporated into broader political organizations. The definition of the NPC tends to structure the qualities of these organizations because, depending upon which identities get mobilized, some groups are likely to join certain organizations and not others. Some organizational bases are commonly accepted as salient and important, while others are dismissed as irrelevant and without meaning. For example, regional organizations are less likely to form when regions have little salience in a constitution and have never formed part of the national imagination. Racial organization is similarly unlikely when that category has no political salience. Leaders of particular groups – whether they be political parties; religious, ethnic, or racial groups; trade or employer associations; or issue-oriented groups – are likely to be politically influential depending upon the degree to which they are recognized within a particular political order.

Group identities – and again, the cohesion or fragmentation of economic groups or classes – are also mobilized through the creation of social norms and through the creation of idioms and rhetoric about who and what matters. Such institutions provide information both to the state and to societal actors about which groups can be understood to be having common

[23] North 1990: 7.

interests and which are understood to be in conflict. These less formal institutions provide frameworks for making sense of the political world in which people live.

Upper-Group Calculations and Strategies

The structure of class relations, including the strength of broad coalitions among upper groups, and between upper and lower groups, strongly influences the political calculations and strategies of upper-group actors. Although the political community model takes into account the political influence of lower groups, I focus on the political calculations and strategies of the economically privileged sectors of society. Upper groups – comprised of high-income individuals, firms, and organizations – are critical to the development of the tax state because they control the lion's share of taxable resources, particularly in highly unequal societies such as Brazil and South Africa. The incentives for all individuals and groups to free ride on the tax payments of others are high, and wealthier actors within society generally possess extensive capabilities to influence the development of tax policy, and to avoid and/or to evade the tax burden when they are so inclined. In the absence of cooperation, or "quasi-voluntary compliance"[24] from upper groups, the state will seek out other forms of revenue that may be less reliable, more complex, and may exacerbate inequalities within society. At least initially, the state's authority over upper groups depends upon the willingness of those actors to cooperate and to comply with state initiatives.

When upper groups within a society come to *share* a common and meaningful political identity, this is likely to lead to high levels of class cohesion, and the state executive will find it much easier to provide bargains and credible commitments that will actually appeal to those upper-group interests than if there is significant political fragmentation. In turn, willingness to comply is a function of perceptions of normative obligations and calculations about the *collective* benefits of tax payment. Group identity and a sense of where the "other" lies are important determinants of such sentiment. Within the public economy, individuals are more willing to pay when they are confident that the benefits will be restricted to "our" group. If there is a perception that the state will transfer benefits to "them," or some other group, or if the barriers to in-group membership are permeable, citizens

[24] Levi 1988: 48–70.

are less likely to perceive tax payment as a beneficial or rational move. People are more willing to pay if the state can make credible promises that the money will go to "us," either in the near term, or as an intertemporal or intergenerational transfer. The central state attempts to negotiate its desire to collect revenue, calculated against the costs of anticipated resistance, including monitoring and enforcement costs. It may adjust its proposals and desire to impose uniform authority, in line with the realities of varied levels of political support within society.

To the extent that the state makes appeals to this sense of common identity, upper groups will more likely be willing to pay taxes, as they will be motivated by a sense of normative or ethical group obligation *as well as* self-interest. They are also more likely to believe that others, sharing a common, collective identity, will perceive the situation in a similar manner, and will comply with the state's demands for payment. Within-class cohesiveness also provides opportunities to strike *cross*-class bargains, in which upper groups are willing to bear the weight of a progressive tax burden as a financial inducement for lower groups. Alternatively, when upper groups are more politically fragmented, cross-class bargains are much less likely to be implemented.

When responding to state demands for tax payment, upper groups make calculations and develop strategies based on the objective circumstances in front of them. However, the political community model emphasizes that the salience of group identities, and the ways in which those identities overlap with the allocation of economic resources, affect the degree to which individuals and groups with common economic means will view their long-term political and economic interests either as shared or as competing. Because individual and collective actors have little information about the future, and particularly little information about how the state's actions are likely to benefit them as *individuals*, they can use political identity to make group-based calculations, assessing the degree to which state action is likely to serve "us" or "them."

When upper-income actors see their collective political identity as shared with that of lower groups within society, particularly in ways that clearly differentiate them collectively from a relevant "other," the prospects for collecting progressive taxes are further increased, as upper groups are more likely to accept some of the tax burden away from those with less ability to pay. A shared identity connotes some degree of horizontal camaraderie and suggests that future returns for the entire group will depend, at least to an extent, upon the well-being of its economically least-well-off members.

When upper groups are willing to make collective sacrifices, they are less likely to make taxation a highly partisan issue and more likely to allow technical experts within the state to make decisions about the structure of the tax code. Cooperating upper groups may even serve as partners with the state, assisting in the writing of extractive and efficient tax codes, and in the administration of the tax system.

Alternatively, when salient political identities *fragment* economic classes – that is, when groups with similar economic means do not share common political identities – upper-income actors will more likely interpret state expenditures in terms of how they serve "other" groups, implying that tax payment would be a bad or irrational investment in the future. Under such circumstances, groups are much more likely to mobilize against state demands for tax payment based upon equity grounds – that is, that the "other" group ought to pay more relative to the status quo. In other words, upper groups with identity *A* will compete with upper groups with identity *B* regarding who should bear more of the tax burden, ultimately making the state's goal of taxing both groups more difficult. The executive may be forced to make more narrow bargains to secure support. When the support of multiple, conflicting groups is necessary to write a set of tax policies, such codes are more likely to be ridden with loopholes. Competing claims regarding fairness impede the taxation of upper groups, forcing the state to write tax codes with greater levels of complexity and fiscal *illusion* (the use of multiple, often hidden, tax instruments that obfuscate the true tax burden paid by citizens to the state). Within such a dynamic, upper groups may also step up their efforts to avoid and/or evade their obligations, hindering the tax bureaucracy in its efforts. The relationship with the state winds up being more adversarial.

The Political Community Model Applied to Brazil and South Africa

When applied to the cases of Brazil and South Africa, this model is used to investigate the impact of racial and regional identities on class relations and the politics of taxation. In both countries, skin color has been largely, but not perfectly, correlated with income and wealth, to the extent that almost all upper groups have been light skinned, and most people of color have been poor and working class, though many whites have also been poor and working class. Despite these similarities, varying definitions of NPC have produced contrasting patterns of identity formation and class politics. The political mobilization of race in an exclusionary manner in

South Africa helped upper groups to see their interests as more shared than competing. “Whiteness” or “Europeanness” framed the collective interests of upper-class actors spanning a wide range of economic sectors and diverse regions within the country. Although lower groups in South Africa have been largely dark skinned, the definition of a white NPC also facilitated strong cross-class linkages between the white lower groups in that country and the virtually all-white upper groups. Despite important social, economic, and cultural differences across regions, the choice to develop a unitary state implied that regional claims for special treatment would fall on deaf ears in the political arena. By contrast, in Brazil, where race was not made salient, class relations unfolded in almost the exactly opposite manner. The salience of regional identities born out of Brazilian federalism created deep-seated divisions among people even with largely similar economic means. In that country, the virtually all-white upper groups came to see their interests as more competing than shared, and Brazilian federalism further exacerbated the distance *between* economic classes by providing idioms for mobilizing a sense of difference. As a result, the politics of taxation in South Africa has been characterized more by cooperation, and in Brazil, more by conflict.

Mechanisms of Reproduction

Although the explanatory variables identified in the political community model may all take on a wide range of values over time, trajectories of state development tend to be reproduced through nationally distinctive political logics. In recognizing the stickiness of political patterns and the national structures of taxation, this book draws insights from several strands of institutional analysis, especially an emerging stream of historical institutional analysis that shares a concern for explaining enduring, national patterns of variation in policies and outcomes. The most relevant example is Sven Steinmo’s *Taxation and Democracy* (1993), which investigates the political institutions of Sweden, the United Kingdom, and the United States, and their impact on the development of modern tax policy.[25] As others have found, even in the wake of potentially homogenizing external shocks, nationally distinctive patterns or paths are not easily changed. The exact idioms used for politics or the proper names of political organizations may change, but

[25] Other prominent examples of historical institutional analysis include Pierson 1994; Ertman 1997; Immergut 1992; Zysman 1994.

the ideas and myths that hold some groups together and keep others apart may be reinvented and adapted to new circumstances over time. Indeed, some of the mechanisms through which institutions shape identities and politics are part of a more general phenomenon that many describe as *political culture*. It is important to note, however, that such cultural attitudes, norms, and beliefs have specific institutional origins, and are mutable within the context of institutional change.

Because the costs of inventing new bases for political mobilization are likely to be high, political entrepreneurs typically have strong incentives to preserve existing patterns of political organization, and institutional stickiness maintains a consistent rhythm to politics over long periods. The idea that some people are insiders and some outsiders, that some groups are allies and others adversaries, becomes a natural part of political life in a given society, shaping reactions and counter-reactions to particular political orders. It is simply easier and less expensive to re-apply old political idioms and organizations than to re-invent new ones, and past experiences provide an important guide for making decisions about the future. Of course, the degree of institutionalization of the NPC may vary across societies, but this generally increases as particular identities, rules, and common-sense frameworks are taken for granted as the perceived reality of politics. Even when there is consensus that a particular form of political organization is generally detrimental to the well-being of a society, political entrepreneurs may find it difficult to agree upon rules that would fundamentally change the institutional foundations of politics.[26] Because the rules defining the NPC affect tax policy and administration, the resilience of these rules implies an associated dynamic for the politics of taxation.

Further influencing the tendency toward pathway development, patterns of taxation tend to reproduce themselves independent of the other exogenous factors identified in the political community model.[27] As a result, the timing and sequencing of critical junctures and of state development prove to be extremely important. Early divergences set states on quite different trajectories, making subsequent convergence enormously difficult even when other circumstances and other factors are highly similar. That is not to say that politics or external economic factors become unimportant. Rather,

[26] For a discussion of this problem with respect to the obvious need for political reform in Southern Italy, see Putnam 1993.

[27] Others have observed the stickiness of tax regimes. See, for example, Ames and Rapp 1977.

as societies become accustomed to particular sets of policies, compliance patterns, and administrative capacities, change is much more likely to be marginal than wholesale. Because taxation is such a central aspect of national life, patterns of taxation are likely to reinforce the material and organizational bases of the political arena, which shaped the tax state in the first place. In other words, "actors adapt their strategies in ways that reflect but also reinforce the 'logic' of the system."[28] Moreover, once certain policies are codified into law, or patterns of collection are regularized, through computerized or other mechanisms, the costs of change increase, generating a technological form of path dependency.[29] Bureaucracies that benefited from good citizen compliance in earlier periods gain the information and skills to enforce compliance in later periods. The institutions through which tax policy gets evaluated and shaped tend to be highly resilient, even once initial conditions are no longer recognizable. Together, these factors serve as powerful mechanisms of reproduction even under radically changed circumstances. Such observations imply that purely cross-sectional attempts to understand variations in taxation outputs, and state authority more generally, are likely to be highly limited.

Among political scientists, economists, and sociologists, observations about the powerful influence of institutions have become increasingly prevalent. In recent years, a common *theoretical core*[30] has emerged, and there is significant evidence of cross-fertilization of approaches to the role of institutions in political life.[31] Nevertheless, it is useful to try to be clear about real scholarly disagreement. For example, according to the rational choice institutionalists, "institutions . . . induce choices that are regularized because they are made in equilibrium. In equilibrium, no actor would unilaterally choose to alter his or her behavior, given the options, the payoffs, and expectations regarding the choices of others."[32] Although I do not challenge this observation (and it would be difficult to refute empirically), I do not find the rational choice/game theoretic treatment of politics to provide significant added value for understanding the role of institutions for the problems and cases I consider. As in the rational choice approach, I agree that actors make calculations and strategies in order to pursue their

[28] Thelen 1999: 392.
[29] Thelen 1999: 384; Pierson 2000.
[30] Immergut 1998: 5–34.
[31] Thelen 1999.
[32] Bates et al. 1998: 8.

best interests. Rather than starting with actors and a given set of costs and benefits, however, I find that institutions *define* which collective actors get to "play" the game of politics, and they help to define the preferences of those actors. For example, should we assume that a light-skinned person will always value "white rule," as was the case in South Africa? Only if being white appears to matter, and if blacks are seen as the relevant "other," which the Brazilian case demonstrates is not a foregone conclusion. It would be reasonable to assume that all upper groups will pursue strategies that help them to stay wealthy, but their allies in this political game vary depending upon how institutions structure the political landscape. Similarly, the normative claims made by political leaders that motivate strategies and actions are likely to vary according to institutional environment. The benefit of the historical institutional (HI) approach is that such aggregation of actors and preference functions are made problematic, and not assumed.

Moreover, as compared with rational choice analysis, and its stated commitment to individual-based analysis,[33] this HI analysis does not focus on individual behavior and choices. Particularly when it comes to taxation, individual-based information about costs and benefits is so imperfect that it is simply beyond comprehension that any actor could make an accurate assessment of how these compare. Rather, a macro-level logic, in which individuals perceive themselves to be members of groups, and political leaders help them to evaluate how they are benefiting and how they ought to contribute as *members of the group*, appears a much more accurate representation of the reality in which people live. The HI approach focuses on how those groups develop and gain power within the political arena, and assumes that most members of society will pursue their interests in line with those of the most politically relevant groups to which they belong. Principals and agents act within particular institutional frameworks, and when trying to understand macro-level variation across countries, it seems more pressing to focus on understanding key similarities and differences in those institutions and the political logic they engender rather than to evaluate the calculus of individual action at the margins – which is the analytic value added of a microeconomic approach such as rational choice theory. The HI approach is more useful for understanding big differences across countries, particularly when the institutional environments are not well understood.

[33] However, in practice most rational choice work analyzes aggregated actors.

The rational choice institutional approach is more useful for understanding particular decisions within well-specified institutions.[34]

Alternative Explanations

In order to evaluate the plausibility and value of the political community model, rival explanations of the determinants of taxation outcomes must be examined. As has been discussed above, explanations emphasizing the role of economic and international factors need to be considered. In addition, this book evaluates the insights derived from explanations emphasizing bargaining power, the trustworthiness of the state, regime type, bureaucratic capacity, and culture. In certain cases, I point out that the political community model provides a better specified, but not necessarily contradictory, argument. In other cases, truly alternative and testable hypotheses can be derived, which are explored in later chapters of the book. When examining the Brazilian and South African histories, I also consider country-specific arguments that highlight the causal role of noted historical events and developments. I demonstrate the limits of these accounts when seen in broader comparative perspective.

Bargaining with the State

In many important ways, the political community model presented above reflects an attempt to build upon Margaret Levi's model of predatory rule.[35] She argues that the emergence of revenue systems can be modeled as the product of a bargain or contract between a ruler and the ruled, or state and

[34] Increasingly, rational choice scholars have begun to loosen the assumptions under which they analyze politics, employing more interpretive methods, abandoning the individual as the unit of analysis, and conceding that preferences can be shaped by institutions. In these cases, I find little difference between their enterprise and that of the historical institutionalists. See, for example, Bates, de Figueiredo, and Weingast 1998: 603–42. Similarly, with respect to the new institutionalism in economics, a wide variety of assumptions are employed. Many New Institutional Economists believe that competitive markets produce efficient outcomes in well-specified settings, that outcomes can always be explained in terms of individual utility-maximizing behavior, and that preference formation is unproblematic. In these respects, the political community model shares little common ground. However, in considering more recent scholarship from this school, such as Douglass North's work, in which he abandons an efficiency view of institutions (North 1990: 7), it is again difficult to draw sharp distinctions between the various institutionalist approaches.

[35] Levi 1988.

citizen in more modern times, and she highlights the importance of quasi-voluntary compliance on the part of citizens, as an ultimately determining influence on the structure of state revenue. In order to generate significant amounts of tax revenue, the state must provide a contract or bargain that is fair.[36]

What accounts for differences in the ways in which revenue contracts emerge across time and space? For Levi, structural factors, such as changes in the mode of production and the international environment, as well as changes in forms of government, affect the relative bargaining power of states and citizens, their time horizons or discount rates, and the transaction costs of negotiating and implementing tax policies. She hypothesizes that revenue-maximizing rulers will be able to increase revenue when their bargaining power is greater relative to subjects or citizens, and when the transaction costs of negotiating and enforcing a tax contract are lower. Further, she argues that when rulers discount the future more heavily, they will attempt to extract much higher levels of revenue, even to the detriment of long-term productivity within the economy. Using this model, she attempts to account for differences in the development of revenue systems across time and space. For example, she argues that as military technology changed – becoming more expensive and requiring greater centralization – the bargaining power of rulers to impose war-based taxes increased. "Monarchs needed more funds to win battles and were the obvious persons to organize war. These facts gave them considerable ammunition in the claim that taxpayers gained from contributing."[37] Looking comparatively at royal taxation, she concludes that, because of "the relatively greater bargaining power of French than English monarchs in relation to nobles, French monarchs would be able to impose a greater range of lay taxes than English monarchs."[38]

Despite the powerful insights of the argument, including its emphasis on the role of structural and strategic factors on state development, and on the importance of citizen compliance and voluntarism in the production of revenue, the model fails to capture the various ways in which the political environment can be affected by socially constructed factors, such as the mobilization of group identities, or rhetorical appeals to normative concerns. In emphasizing the centrality of the state, Levi's study does not

[36] Levi 1988: 48–70.
[37] Levi 1988: 106.
[38] Levi 1988: 96.

adequately address the influence of the varied political configurations of society.[39] Indeed, the mode of production and the international context cannot account for key differences in the operation of politics or taxation outcomes across Brazil and South Africa, suggesting the need for a more nuanced explanation. A better specified model would incorporate the prior factors that affect the bargaining power of actors, their discount rates, and associated transaction costs of making and enforcing bargains with the state. Without such additions, it becomes all too easy to make claims about the sources of these rather general analytical variables in a post hoc manner.

The political community model adds an important degree of specificity to Levi's argument by focusing on upper groups in society and by recognizing definitions of NPC as a key determinant of actor preferences, aggregation, and strategies. It argues that such definitions, which give political salience to certain identities and not others, influence inter- and intra-class relations, in turn affecting the actions of key political actors, ultimately shaping tax policies and tax administration. In highlighting the role of quasi-voluntary compliance and the strategic interactions between state and society, this model very much builds on Levi's. However, a key difference is that Levi's analytic variables – bargaining power, transaction costs, discount rates, time horizons, and notions of fairness – are made endogenous. The potential drawback of this move is that the scope of application of the model is more limited, while the advantage is that the predictive power is greater, as the relevant explanatory variables are more thoroughly and restrictively specified. The political community model is more vulnerable to falsification through empirical investigation because we can establish a greater proportion of the relevant contextual factors ex ante.

Trustworthiness of the State

One prominent alternative account of variations in revenue collections and structures, and of citizen compliance more generally, focuses on the trustworthiness and credibility of the state executive and the bureaucracy.[40]

[39] In a later work on military conscription, Levi (1997) develops an argument about the determinants of "contingent consent." The argument in this book is more explicit about the role of norms of fairness and the possibilities for ethical reciprocity within ethnic and racial groups.

[40] This argument is also associated with Levi's (1988, 1997) work. For a review of this literature, see Levi and Stoker 2000. Levi's 1988 study of taxation conceptualizes and measures

Specifically, one could hypothesize that the problems of corruption and of the failure to gain the trust of upper-income citizens have been more acute in Brazil than in South Africa, and that this variation explains important differences in the amount of direct income tax revenues collected. To be sure, there is far more bribery of tax collectors and deceptive reporting of financial accounts in Brazil, particularly among the business elite, but the question is, why?

Although perceptions of corruption, credibility, and trustworthiness influence taxation outcomes, we gain more analytic leverage if we consider these factors as part of the puzzle that needs to be explained, rather than as exogenous determinants of tax compliance and levels of collection. Corruption on the part of tax collectors – in particular, the deliberate undervaluation of the tax liabilities of a firm or individual in return for a bribe – is simply one aspect of the outcome under investigation. I assume that most tax collectors are vulnerable to graft, but it is only when citizens actively attempt to evade their tax liabilities that tax collectors engage in such behavior as a regular practice. Tax fraud, whether carried out in partnership with the state's agents or not, is a phenomenon that is conceptually so proximate to the outcome of measured levels of collection that it is hardly useful to say that the former "explains" the latter.

An important argument emphasizing the role of trust concerns the types of *social capital* that Putnam (1993, 2000) has identified in his various works on the functioning of civil society. In his study (1993) comparing the varied functioning of Italian regional governments, Putnam argues that the *horizontal* networks of trust within Northern Italy have facilitated more efficient government than the *vertical* networks of Southern Italy, because citizens are more likely to trust the actions and behavior of their fellow citizens and elected leaders in the former case than in the latter. Building on this argument, Joel Slemrod (1998) proposes – though he does not empirically examine – that this hypothesis is likely to apply to the realm of national taxation systems. Similarly, Scholz and Pinney (1995) explain voluntary compliance as at least partially due to a sense of duty. I do not contest that duty, trust, and social capital are analytical constructs that capture aspects of the societal relationships necessary for cooperation and collective action that

the outcome somewhat differently than I do, in that she explores types of revenue systems, whereas I consider the extent to which the state can effectively collect certain types of taxes, as discussed in more detail in Chapter 2. Levi's 1997 work is concerned with military conscription – a related but clearly distinctive outcome.

are central to the process of taxation and of governance more generally.[41] Yet again, these concepts remain so intertwined with patterns of compliant behavior that we cannot easily distinguish between cause and effect.

At a deeper level, in order to assess the arguments posed by Levi and by others who emphasize the influence of credible commitments made by government leaders, it is necessary to explore the hypothesis that citizens are less likely to meet their tax obligations quasi-voluntarily if they believe that the national treasury is being pilfered for private, narrow gains, or if they believe that state revenues are not being spent fairly. In both Brazil and South Africa, and certainly in many other societies, the citizens who challenge the state's demands for tax payment in the policy arena or through aggressive avoidance and evasion strategies typically justify their resistance to taxation with the claim that they are not getting a fair deal, and that the money is being wasted on bad policies, poor implementation, or through outright stealing by individuals in government. Perceptions of corruption or perceptions that one's interests are not being considered are likely to make the government seem less trustworthy, and as a result, citizens can justify their challenges to the state's demands for tax payments. At the extreme, when state executives and their agents demonstrate a wanton disregard for public interests, and when virtually no government services are provided, it would be reasonable to predict that citizens will resist tax payments.

An important problem with hypotheses concerned with credibility and trustworthiness is that it is very difficult to define and to measure such influences. What is a well-intentioned redistributive project for some may be interpreted as evidence of corrupt patronage for others. By its very nature, "actual" corruption is virtually impossible to measure at a macro-level scale because the very concept implies a relativistic understanding of what is legal and acceptable behavior. Ironically, transparent democratic institutions, such as a free press, may lead the average citizen to *perceive* higher levels of corruption, and/or lower levels of trustworthy and credible behavior, simply because such information is made available to an extent that is not true in less transparent but potentially more corrupt polities. Certainly, in the cases of Brazil and South Africa, for most of the 20th century, the respective governments have demonstrated through substantial expenditure

[41] See, for example, the various contributions in Braithwaite and Levi 1998 and the review of the literature on political trust and trustworthiness in Levi and Stoker 2000.

projects that the treasury has not been used *exclusively* for the personal gains of government leaders. Massive modernizing development projects were carried out in both societies,[42] major infrastructure projects were completed, and in both cases, these largely served the (upper-income) citizens who were liable for the payment of income taxes. In both countries, there exist documented accounts of illegal and corrupt behavior on the part of state leaders as well as of low-level bureaucrats, but such anecdotes provide little clue as to the extent to which *actual* corruption has varied across the two countries. Neither country has had a profligate dictator such as the former Zaire's Sese Seko Mobutu, and particularly during more authoritarian periods, the respective states have been governed by regimes committed, at least to a degree, to the development of professional, legal-rational bureaucracies. In short, there is little empirical evidence that can lead us to conclude that a more corrupt or untrustworthy state is to blame for Brazil's relatively weaker record of income tax collections, despite over a century of attempts to increase collections.

If not *actual* state corruption or trustworthiness, what can account for cross-national variation in *perceptions* of credibility? As Levi points out, "political and cultural organizations can also affect perceptions of the trustworthiness of government and of the extent of ethical reciprocity."[43] This suggests the need to look more closely at such factors in comparative perspective. Perceptions of state action on the part of individual[44] and collective actors may be largely determined by political context, independent of the goods and services the state actually provides. The political community model provides a framework for understanding how citizens interpret state action.

Culture

A conventional explanation advanced by scholars and others for cross-national differences in tax policy and tax administration is a theoretical black box often labeled *culture*. As discussed earlier, there is a cultural aspect to the

[42] Though in both cases, with tragic consequences for human development. See the discussions of these projects as described by Scott 1998.

[43] Levi 1997: 27.

[44] As I have shown elsewhere (Lieberman 2002), individual perceptions of getting a fair deal, and of their inclinations to comply with tax obligations, are strongly influenced by their level of agreement with the definition of NPC.

political community model, but it is contained within a theory of political institutions. Alternatively, culture is frequently identified as an autonomous causal influence on key political and policy outcomes. Cultural factors potentially provide the most powerful alternative hypothesis because they are often difficult to disprove. Indeed, as a last resort, many analysts of taxation identify cultural differences as the basis for unexplained variations that tend to be sustained across countries over time. Of course, this is a large category with quite varying notions of how to define the concepts, let alone the specification of the causal mechanisms involved. Thus, in order to seriously consider the impact of culture, both theoretical and empirical investigation is necessary.

Again, it is critical to separate cause and effect. If patterns of taxation or patterns of compliance are described as tax cultures, then culture cannot be said to explain patterns of variation. This would be true by definition. Scholars have observed that across time and space, different norms and practices of taxation develop in particular places. In other words, they argue that the very policies and practices that comprise the tax state constitute their own nationally distinctive cultures. Webber and Wildavsky's (1986) discussion of tax systems around the world is an important contribution in its identification of differences in budgetary systems across places and history, but this presentation lacks a true theory of why such patterns emerge in the ways they do. As a result, no testable hypothesis can be derived when culture is defined as the *outcome*.

More sophisticated conceptions of culture advanced by analysts such as Weber (1991); Almond and Verba (1963); Inglehart (1990); Inglehart and Carballo (1997); and Swank (1996) have described culture independently, as a set of shared norms, values, and beliefs that tend to structure politics and particular outcomes. Although an institutional theory of identity is certainly a close cousin of many cultural approaches, the institutional argument of the political community model differs from the cultural one in that material interests still ultimately motivate politics, whereas in the cultural theory, cross-national variations are explained by variations in norms and values per se. To a limited extent, we can adjudicate among these arguments through empirical analysis. A standard refrain in this regard is that taxation is easier in Protestant, Anglo-Saxon cultures, whereas in Catholic, Latin, or Iberian cultures, states have a difficult time collecting taxes. For example, Haycraft argues that the high level of tax evasion of direct taxes in France and Italy relative to other European countries is the product of Latin suspicions of the state on the part of French and Italian citizens, and that such values ultimately generate a greater reliance on indirect taxation in those countries.[45]

An important challenge in adjudicating among cultural and institutional hypotheses is the potentially spurious correlation between what is observed as culture and the outcome under examination. If they are both caused by the same set of factors, culture will tend to covary with taxation systems even if the causal relationship between the two is weak or nonexistent. In particular, the notion of *colonial legacies* – the social and/or political inheritance of empires – is an example of this form of relationship. Former colonies have tended to inherit both institutional and cultural qualities from the imperial state. Many English-speaking societies (particularly former British colonies) may share similar political dynamics and similar taxation capacities, but the institutional argument will suggest that this stems from similarities in institutional constructions rather than from Anglo-Saxon or Protestant values. Similarly, the resistance to taxation on the part of citizens in Latin societies has more to do with a commonality of political institutions, including the ways in which the NPC is configured, than with a more deep-seated set of values inherently opposed to the welfare state or the civic realm. The political community model is explicitly an alternative to such arguments. Most importantly, the model predicts that the definition of NPC will produce a distinctive legacy for the outcome under investigation independent of that produced by constant causes or antecedent conditions existing within countries prior to the critical juncture.[46]

Undoubtedly, the explanatory power of cultural factors is difficult to assess both on theoretical and empirical grounds, but through process tracing and careful observation, it is possible to assess the degree to which one or another set of influences shapes tax policy and administration. In particular, the nature of change over time within countries often provides clues about the relative influence of culture when compared with other factors. Broader cross-national comparisons provide additional insights. This book evaluates the hypothesized effects of colonial legacies and religious orientations as potential cultural influences, and ultimately, does not find support for such explanations.

[45] Haycraft 1985, as cited in Peters 1991: 5.
[46] Collier and Collier 1991: 30.

Alternative Explanations

Regime Types

A central task for students of comparative politics has been to characterize the relationship between the nature of the political regime – democracy or dictatorship – and the quality of state authority. This analysis helps shed light on this question by measuring state authority in terms of operational measures of taxation. Theories about the relationship between regime type and extractive capacity suggest conflicting hypotheses. On the one hand, democracies may legitimize the state's authority by providing real and perceived recognition of taxpayer interests, following the logic of "no taxation without representation." On the other hand, authoritarian governments may be better at limiting the numbers of demands and conflicting interests articulated within a society, and they may be more willing to use coercive and invasive tactics to collect revenue. For example, they may severely fine or jail tax cheats, or use search and seizure methods of investigation in a manner or to an extent generally not practiced or acceptable in democracies with strong protections for civil liberties and potentially long and expensive legal procedures. While Cheibub's (1998) multicountry statistical study finds that on average, democracies collect more (total) taxation than do dictatorships, many of the causal factors found to be associated with regime types are themselves strong influences on taxation, leading to the conclusion that regime type probably has no independent effect. Since this study uses different measures of the tax state (see Chapter 2), and employs different methods of analysis, it is possible to re-assess the alternative hypothesis that regime type affects state performance. This hypothesis can be evaluated from a static perspective – comparing countries at a particular moment in time, or from a dynamic perspective – investigating the influence of regime changes within each country over time.

Bureaucratic Performance: Leadership and Professionalism

In a practical sense, tax collection is a form of public administration, and the quality of the bureaucracy likely provides a strong proximate explanation of the relative success of different states in collecting taxes.[47] Indeed, much of the public finance literature written by the taxation specialists of the major international financial organizations identifies the poor technical quality of administration in developing countries as the root of high levels of evasion

[47] The notion of the legal-rational bureaucracy is generally associated with Weber 1968.

and low levels of collection. Authors of multiple prominent case studies on the development of tax systems and tax reform around the world have pointed to the importance of a well-functioning, well-trained bureaucracy on tax collection.[48] The implication of such arguments is that it is possible to improve the performance of collections by reforming the technical skills of the state bureaucracy, independent of other concerns.

As it turns out, technical skills are a necessary but far from sufficient basis for collection. In an environment in which evasion and false reporting are the norm, the most skilled administrators will find it difficult to effect significant change. Society plays at least as important a role as the state in the collection of taxes, and the efficacy of the state is not likely to be high without the cooperation of citizens. We can evaluate a narrower aspect of the rival explanation which has direct implications for policy makers: If we separate the concept of professionalism (training, technical skills, numbers and types of employees, promotional criteria) from performance (success in collecting taxes) and use available measures of bureaucratic professionalism, it is possible to measure the strength of this relationship.

Plan of the Book: A "Nested" Approach to Comparative Analysis

The central objectives of this book are to explain why Brazil and South Africa have such different tax systems, and to provide a more general accounting of the factors that influence cross-national variation in the state's ability to extract revenue from economically privileged groups in society. The book investigates the explanatory power of the political community model, and the various alternative frameworks discussed above, through a "nested" research design that draws inferences from comparative case study and cross-national statistical analyses.

Primarily, the argument is developed and explored with a comparative historical analysis of the development of the tax state in Brazil and South Africa. Focused, comparative analysis provides a remarkably powerful basis for making causal inferences about historical institutional theories. Comparative, cross-period analyses within the historical record provide multiple opportunities to measure the causal effects of institutional and other explanatory variables. Establishing chronologies and sequences is vital in a discussion of relationships in which the plausibility of the causal arrow pointing in the opposite direction is quite high. Understanding

[48] Boskin and McLure 1990; Gillis 1989; Newbery and Stern 1987.

contemporary patterns of variation demands an analytical excursion backwards to the various forks in the historical road, constantly questioning the extent to which "it could have been." Moving forward through history, we can observe the extent to which options become opened or closed off because of prior actions and outcomes. By analyzing the treatment of similar policy proposals at similar moments in time, it is possible to consider the influence of other factors on outcomes. In particular, the analysis of primary documents and interview transcripts reveals how differently the calculus of action has been in these different contexts.[49]

That analysis is embedded within a statistical analysis of a multicountry dataset with valid data from the period 1970–94.[50] Such a mixed approach compensates for the inferential limitations generally associated with standard research strategies in comparative politics: On the one hand, two-country studies often suffer from limited analytic leverage, whereas large-N studies may suffer from problems of poor measurement, conceptual stretching, or spurious correlation. The shortcomings of the respective analyses are largely addressed through this analytical marriage. Together, the findings from the comparative-historical and the statistical analyses provide strong support for the central arguments associated with the political community model.

Within the comparative historical analysis, both cross-sectional and over-time analyses generated many degrees of freedom beyond the two country cases central to the investigation, providing yet a further solution to the problem of small-N. This flexible, mixed strategy provides solutions to many of the theoretical and data constraints typically associated with the types of problems raised by HI analysts, including a concern for simultaneously understanding the particularities of specific country cases while attempting to advance more general propositions about the mechanics

[49] For a fuller discussion of these strategies, see Lieberman 2001a.

[50] The data requirements of the project are diverse and far-reaching. See Chapters 2 and 6 for fuller explication of the sources of the statistical data. The comparative historical analysis is based upon extensive field research, supplemented by archival research in the United States and extensive consideration of secondary source materials. Extensive archival materials were gathered in both countries, including government and nongovernment reports on the tax system, newspaper coverage of tax politics, and various publications from business, labor, and political organizations. Over 150 structured, open-ended elite interviews were conducted with tax bureaucrats, political party leaders, tax lawyers, accountants, consultants, relevant analysts of the tax system inside and out of government, top business leaders, and representatives from international financial institutions.

of political life. As a result, the conclusions can be accepted with a high level of confidence.

Although the findings of the research are presented separately in terms of the comparative historical research on the one hand and the statistical analysis on the other, such presentation belies the iterative discovery process that was central to the research and analysis. Moving back and forth between small-N and large-N analyses provided opportunities to sharpen the analysis and to verify hypotheses generated at one level with data from the other level. The paired comparison was critical for developing and illuminating central concepts and causal relations within the analysis, particularly for identifying difficult-to-measure factors, including political discourse and interpretation. Longitudinal analyses within country cases provided opportunities to explore rival explanations, causal order, and the operation of legacies. The cross-national statistical analysis was useful for framing the paired comparison, measuring the influence of rival explanatory factors, and for testing the broader explanatory power of the central model. Early in the research, such statistical analysis helped to confirm the value of the paired study. For example, the simple scatter plot and correlational analysis presented in Figure 1.2 help to make clear that varied levels of income tax collections between Brazil and South Africa are truly puzzling when seen from a broader comparative perspective. I decided to pursue a more nuanced political-historical explanation after finding that I simply could not account for this variance despite attempts to specify several multivariate models incorporating a range of standard social, economic, and political factors. Such strategies represent a significant advance over the use of Mill's method of difference in which there are important limits to the number of controls that can be identified with only a small number of cases.

Before turning to causal inference, however, it is necessary to paint a better portrait of the problem of taxation, and to provide a tool for comparison and measurement. The question of variation in national patterns of taxation is more fully articulated in Chapter 2, which presents a framework for comparative analysis of the development of national taxation systems, or *tax states*. It explains why taxation provides a useful focus for the comparative investigation of state-society relations, building upon the subfield of fiscal sociology. It highlights key differences between the contemporary Brazilian and South African cases by identifying variation in tax policy and tax administration within a larger typology.

Chapters 3 through 5 present the comparative historical analysis of tax state development in Brazil and South Africa. Although the countries are situated in different world regions, different languages are spoken there, and some other obvious differences exist, the selection of South Africa and Brazil as the foundation for this analysis is due largely to their great similarities in social, economic, and geopolitical terms. That analysis draws on the political, economic, and social histories of the two countries in order to make causal inferences about the determinants of tax policy and tax administration in the 20th century.

Chapter 3 provides an analysis of the cleavages, crises, and critical junctures in the two countries. A central task in specifying a critical junctures model is to establish analytical equivalence in the timing or characteristics of the hypothesized critical juncture, demonstrating that contrasts are actually "different values on the same variable."[51] It describes the common problems and challenges of national integration that faced constitutional planners following the onset of industrialization in the late 19th century, and the different ways in which NPC got defined. In particular, the two countries had been divided along the lines of *race* and *region*. That is, perceptions of racial heterogeneity combined with racial prejudice, along with competing ethnic and ethno-regional claims to power, contradicted the unity implied by the notion of shared nationhood. After major political conflicts and upheavals in the respective countries, periods of indeterminacy ensued, and political elites gathered in formal bargaining processes to negotiate new constitutions and to develop new definitions of NPC. Following the conclusion of the Boer War in 1902, constitutional architects in South Africa eventually agreed upon an explicitly racially exclusionary, white union for their 1909 constitution. By contrast, their Brazilian counterparts, prompted to the negotiating table by the overthrow of the emperor in 1889, created an officially nonracial federation in their 1891 constitution. As a result, in South Africa, race became the dominant political idiom for politics while in Brazil, regionalism emerged as the dominant idiom, with important implications for the emergence of class relations in these countries.

Using comparative historical analysis of the development of the tax state in Brazil and South Africa in the 19th and 20th centuries, Chapter 4 explores the power of the political community model to provide useful insights into the unfolding of cross-national variation. It traces the link between the process of industrialization and new pressures from the international

[51] Collier and Collier 1991: 32.

environment on the one hand, and the political dynamics associated with the NPC on the other, and the joint effect of these causal factors on the development of the tax state. Overall, South Africa's racial coordination is found to have provided the political glue necessary for the state executive to command high levels of sacrifice from upper groups. Meanwhile, Brazil's regional fragmentation generated intra-elite competition, producing a zero-sum political game and high levels of private resistance to such taxes. In Brazil, no analogous political "glue" to that found in South Africa could generate a sense of common identity and purpose among upper economic groups. As a result, the Brazilian state executive has consistently found it difficult to tax upper groups. Both from the perspective of policy and administration, South Africa's tax state developed in a much more efficient and progressive manner than the Brazilian one.

Chapter 5 provides a more temporally focused analysis of the politics of taxation at the end of the 20th century. It considers taxation in an era of globalization, democratization, economic liberalization, and the historic collapse of apartheid, a period during which all major domestic and international trends would lead one to predict increased convergence in national tax policies and administrative practices. Yet, the chapter finds that far from converging, patterns of taxation have remained nationally distinctive during this period: South Africa's tax state remains extremely efficient and progressive – if somewhat less so than in previous years – while Brazil's remains highly inefficient, complex, and regressive. The chapter demonstrates the powerful and almost always unintended ways in which the institutional variation first identified in Chapter 3 has cast a long shadow onto the future, reproducing patterns of class cohesion in South Africa and fragmentation in Brazil, as well as pre-existing patterns of engagement with the state.

Returning to the multicountry component of the study, Chapter 6 presents the findings of statistical analyses designed to increase our confidence in the findings from the comparative historical analysis. Regression analysis is used to assess the influence of varied definitions of NPC on the performance measure of the tax state, while controlling for levels of economic development. Robust statistical results confirm that varied configurations of race and region have affected the central state's ability to collect taxes from upper groups in a much larger sample of country cases. Although South Africa and Brazil may be "extreme" cases in terms of the respective salience of race and region, the influence of such institutional variation in the definition of NPC is clearly evident elsewhere. The chapter also demonstrates that several other rival explanatory factors do *not* have an independent influence on cross-national variation. Such findings complement the comparative historical analysis, which could not rule out several rival hypotheses because of its weak statistical power.

Chapter 7 concludes the book by discussing the broader implications of the findings for questions about equitable development, and the future of the tax state, and by identifying avenues for further research. It demonstrates that the legacy of state-building in these two countries has provided South Africa with a tax state far better equipped to redistribute resources in favor of poor blacks than is the case in Brazil. The finding is particularly ironic given that the raison d'être of the South African state for most of the 20th century was the explicit advancement of the white population, to the *detriment* of blacks. Because so much work in the field of taxation has been dedicated to the task of identifying "optimal" models and policy prescriptions, it is worth re-iterating that this is *not* the task of *this* project. The South African political path to the development of its tax state should not be regarded as the preferred one, because a host of other factors not considered here would obviously weigh heavily against such a ridiculous policy prescription. Nevertheless, it is important to be clear that the research does generate a somewhat dismal conclusion – that explicit exclusion seems to provide some of the political "glue" that can help overcome key collective action and coordination problems associated with taxation.[52] Of course, this does not imply that exclusion is the *only* mechanism for generating such political dynamics, but as was true during the processes of war-making and nation-building in Western Europe, the socially constructed notion of solidarity and cohesion that was produced through processes of explicit exclusion in South Africa proved remarkably powerful, particularly when compared with other countries at similar levels of development, such as Brazil.

52 As Russell Hardin (1995) points out, solutions to collective action problems often lead to socially undesirable outcomes.