

Response to Oliver Morrissey's comments on "A Comparative View on the Tax Performance of Developing Countries: Regional Patterns, Non-tax Revenue and Governance"

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We would like to thank Oliver for his helpful remarks. Some of the points he makes (in particular, those suggesting an expansion of the statistical part of our paper) have also been taken up by anonymous referees, and we address them in our comments to the four anonymous reports.

An interesting exercise in collecting data and conducting a preliminary investigation, but I was left looking for more statistical analysis. In particular, there is no consideration of tax base factors that influence potential tax/GDP ratios. Most of the variables considered as potential explanations (in essence of deviations from an average, often a regional average) seem to relate to choice of tax rates (in an aggregate or even specific sense). One could argue that certain groups of countries have similar economic structures and income levels hence similar tax bases (e.g. East Asia, Europe, SSA). In this context, political economy factors (proxied by governance or democracy variables) may explain rates and hence performance relative to the group average. The weakness of the paper is that there is no control for the tax base. For example, as SSA countries have a low tax base one may expect relatively low tax ratios even if rates are as high as feasible (thus authors like Keen argue that SSA countries may be collecting as much tax as feasible).

Oliver makes several valid points here, but we feel we do control for the tax base – even though in its most basic form. We do this by controlling for the level of development, proxied by GDP per capita. Most studies on tax effort and tax performance incorporate more variables, but remain at the level of economic structure (for instance, openness of the economy, sectoral composition, labour market / demographic characteristics), and there is a broad consensus concerning the influence of level of development on the tax base. Oliver's reference to the political economy of tax policy (setting tax rates) is highly relevant, but the relationship between "political will" and structural factors of the tax ratio is extremely difficult to model. We have decided to incorporate this dimension at a later stage of the analysis and in a qualitative framework, arguing that high rankings on the "voice and accountability" and "polity2"-scales indicate a stronger common-interest-orientation of governments.

Some of the effects or relationships posited are more ambiguous than implied. As a specific example, SSA countries may receive aid because they are low income with low tax ratios, rather than having low tax performance because they receive aid.

Again, we cannot agree more. According to our analysis, among low-income countries high tax performers receive significantly more aid than low tax performers. We do not argue in favour of a crowding-out effect of ODA on tax collection.

As another example, governance may not be associated with preferences for collecting taxes. High governance countries can have high or low tax ratios, and improving governance could increase collection efficiency (hence higher ratios) without altering preferences (or rates).

This is in line with our argument. Moreover, we distinguish state capacity ("government effectiveness") from voice and accountability. Singapore, for instance, has a highly capable public sector, yet a low level of democratic governance. In such a case, our guess would be that collection efficiency is high but tax policy not necessarily common-interest-oriented (reflecting the preferences of a society).

A minor comment (p9 and table 3): as noted, SACU accounts for 50% of Lesotho's tax revenue. Lesotho has no influence over this as the SACU revenue sharing formula is based on shares of intra-regional trade plus a redistribution to poorer members (and South Africa chooses the external tariff rates that determine the size of the pool to share). Countries like Lesotho that source most imports from South Africa and are relatively poor therefore derive a disproportionately large share of revenue (Swaziland is also an above average performer; even the relatively richer Botswana and Namibia, who benefit less from the sharing formula, are above the trend line). Given that South Africa makes the net transfers in SACU, perhaps the most surprising finding is that it also is above the trend line.

We are aware of Lesotho, and that is why we do a robustness check by excluding Lesotho from our sample. This does not change our results.