What happens to people's willingness to pay tax when the richest dodge their responsibilities?

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Billions of dollars are yearly withheld from national taxation via a handful of tax havens. How does that affect the tax system and people's willingness to pay tax in developing countries with weak governmental institutions?

This is the point of departure for being a three-year research project carried out under the auspices of the Chr. Michelsen Institute (CMI) in Bergen. The project Taxation, Institutions and Participation (TIP) started in spring 2014. It is funded by the Research Council of Norway in the amount of NOK 15 million.

Little research has been done on how tax havens affect domestic taxation, political institutions and public participation in developing countries. There is therefore little documented knowledge about how the use of tax havens affects tax compliance and lobbying. The researchers want to find out how access to tax havens gives elites and other players incentives to block or promote institutional reforms.

The research team is working on the basis of a hypothesis that individual player's access to tax havens affects everything from the development of tax policy and national legislation to public debate and participation. The goal is to map these effects in developing countries, focusing on Zambia, Angola and Tanzania in particular.

The indirect effect

Odd-Helge Fjeldstad, senior researcher at CMI and head of research at the International Centre for Tax and Development (ICTD), says that, so far, a lot of the research on tax havens has focused on documenting how multinational

companies use tax havens and how much is evaded from taxation in the countries in which they operate. The TIP project aims to focus on the effects of this hidden economy on social systems, politics and tax compliance in developing countries.

Tanzania, Zambia and Angola are three African countries that are similar in some areas, but also different. All three countries are rich in natural resources, but they have different tax systems and forms of government. Angola has oil and diamonds, Zambia has its copper mines, while Tanzania has renewable energy, fishing, forestry, mineral extraction and huge gas reserves.

'Big international companies operate in all three countries and make huge profits. Many of these companies hardly pay tax, however, partly because they report too high costs and underreport the value of their production. They also enjoy generous investment incentives, including tax exemption, from the authorities. Companies that have close contacts with the authorities are often let off, while other companies have to pay tax. This injustice can easily contribute to undermining people's willingness to pay tax,' says Fjeldstad.

He believes that tax havens and capital flight can have different effects in countries with different tax systems, institutions and levels of public participation.

International team

Fjeldstad has put together an international team of economists and political scientists. In addition to himself, Norway's participants are researchers Ivar Kolstad and Arne Wiig of CMI, both of whom have worked on issues relating to globalisation processes and the political economy in resource rich-countries. Like Fjeldstad, Lise Rakner, Professor of Comparative Politics at the University of Bergen, has, like Fjeldstad, also studied state-building processes and tax reforms in developing countries for many years.

The international project partners come from Zambia, Tanzania, Kenya, Angola and the UK. One of the contributors is Caleb Fundanga, who is currently head of the Institute for Finance and Economics in Lusaka. Fundanga is a former Governor of the Bank of Zambia. Elizabeth Kariuki works at the Africa Policy Research Institute in Nairobi, Prosper Ngowi is affiliated to the Dar es Salaam Business School at Mzumbe University in Tanzania, while Alves da Rocha is head of the research centreCentro de Estudos e Investigação Científica (CEIC) at the Catholic University of Angola (UCAN).

Fjeldstad, who has worked on tax issues in African countries for more than 20 years, says that there are many signs that the use of tax havens undermines people's willingness to pay tax to the community. When so many people evade tax, the tax burden becomes greater for those who do pay.

'This can have many consequences. We see that tax laws are undermined through the increasing number of exemption schemes. Strong lobby organisations influence political decisions and block tax reforms that could have resulted in a more fair distribution of the tax burden. The four biggest accounting and auditing firms in the world, called "the big four", play a key role in this context. PwC, Ernst & Young, KPMG and Deloitte have close ties with the authorities in developing countries and are often represented on publicly appointed committees that shape tax legislation. At the same time, they engage in extensive tax planning for global corporations. Corruption in the government administrations has favourable conditions as well, among other things through the buying and selling of tax exemption schemes,' says Fjeldstad.

Field experiment

A key aim of the project is to find out how this unfair system affects people's views on tax policy and the society. The researchers use a field experiment in all three countries, in which selected persons are exposed to different influences. One group is given detailed information about how tax havens work and how capital is withheld from public taxation, while the control group is not given the same information. The participants are interviewed before and after the experiment and have to answer a set of concrete questions about their own attitudes and perceptions. This method is called 'randomised control trial' (RCT). The researchers look at how people's attitudes and behaviour change.

'We hope that this experiment will improve our understanding of how public debate and information about the use of tax havens can shape public opinion. The indirect effects of tax havens and capital flight can prove to be at least as damaging for the countries' national economies as the direct effect of capital flight and the use of tax havens,' says Fjeldstad.

The researchers aim to publish the results in international journals as they become available. They also hope to collaborate with national and international organisations on disseminating research results.

'The development of tax policies and fair tax collection systems is one of the most important elements in relation to developing democracy and state-building,' says Fjeldstad.

Provided by The Research Council of Norway