There has been a revival of interest in the state’s role in economic development. Recent research argues that the most successful economies are those where effective states provide crucial public goods and services. The historical emergence of effective tax systems and the related processes by which public finance institutions evolve are a fundamental part of becoming an effective state.

Unlike the case of Western Europe, where the role of wars and democratization—among other factors—is well established, it is less clear which factors contribute to the ability of states in the Global South to raise tax revenues.

The importance of taxation in developing economies
Higher-income countries collect, on average, more than double the share of total revenues compared to lower-income countries. By region, all others collect substantially lower taxes as a proportion of GDP than North America, Europe, and Central Asia. There is significant room to improve these figures among Global South countries.

There are three reasons why the emergence and consolidation of effective tax regimes matters for economic and social development.

First, tax revenues are needed to provide public goods and services. Typically, governments that collect more tax revenues also spend more on health and education.

Second, acquiring additional fiscal capacity through broad-based taxation has significant positive distributional impacts. Broadly levied income taxation, in particular, can act as a powerful redistributive tool and is a key feature of modern taxation. The proportion of taxes raised through income taxes
Policymakers should be mindful that financing state activities requires developing modern taxation while managing other sources of public finance. Complementarities are important: for example, developing legal institutions protecting property rights or states’ ability to collect information across their territory provides a base to improve tax revenues collection.

Donors and policymakers need to foster processes which engender greater trust in the system by allowing state institutions and citizens to hold governments accountable.

Finally, elites matter. When a country’s politics is based on a dense network of social relations and is able to effectively provide the public goods necessary for broader economic development, political elites are able and more willing to engage in a project of systematic statebuilding.