4. Taxation and the informal sector in the global South: strengthening the social contract without reciprocity?

Michael Rogan

INTRODUCTION

Among both international financial institutions and developing country governments, there is an enduring interest in including more informal sector workers within national and local tax nets. The motivation for taxing the informal economy is related, in large part, to the need for greater 'revenue mobilisation' but there is also a claim that taxation can improve or restore the social contract through greater government accountability and civic engagement (Prichard 2010, Kundt 2017). Supported by emerging perspectives within the 'new fiscal sociology'[1] there is a growing consensus that taxation *is* the social contract and that negotiation and collective action around tax obligations are the key defining relationship between the state and society. However, others, most notably Kate Meagher (2016), have warned that these perspectives have a number of 'blind spots' in relation to developing countries, more broadly, and the informal sector[2] in particular. These include: a 'Euro-centric' conceptualisation of the social contract, a narrow focus on traditional (northern) forms of taxation and a tendency to understand the informal economy as a homogenous group of workers (Meagher 2016). With 61 per cent of the world's workers informally employed, including 67 per cent of those in emerging economies and 90 per cent in developing countries (ILO 2018), these blind spots have a particular relevance for the social contract, political participation, governance and accountability, especially in the countries of the global South.

Moreover, these debates are not purely theoretical. As the impacts of the COVID-19 pandemic and related restrictions have contributed to one of the largest global economic downturns in generations, national governments are likely to search for additional sources of revenue to finance stimulus and recovery packages (Gallien et al. 2021). For example, the Algerian government has proposed the Supplementary Finance Law, which aims to tax the informal sector as an alternative to borrowing from the International Monetary Fund (IMF) to fund the recovery (Hamadi 2020, Gallien et al. 2021). Similarly, in Ghana, a country with very high levels of informal employment (85 per cent of total employment is in the informal sector – see ILO 2018), one of the largest recovery and support packages (the Coronavirus Alleviation Programme Business Support Scheme[3]) requires tax registration as an eligibility requirement even for small own-account-operated firms.[4]

One of the reasons for the longstanding interest in informal sector taxation is that, in countries with a small tax base, a common feature of many developing and middle-income countries, levels of personal income tax are particularly low. Personal income tax, on average, accounts for only about 10 per cent of total tax revenue in developing countries (compared with an average of 25 per cent in developed countries)[5] and this is largely through the taxation of employees from the public sector and large private firms (Keen 2012: 10). In other words, the bulk of the workforce in most developing countries does not pay personal income tax to a national revenue authority. The share of workers not contributing to personal income tax, of course, increases with the size of a country's informal economy (Joshi et al. 2014, Akeju 2018, Resnick 2018). It is to this 'untapped' source of revenue that national tax agencies often turn in attempts to widen the tax net. A recent and poignant example comes from Ghana, where the national revenue authority launched its campaign 'Our Taxes Our Future', which aims to address the 'culture of impunity' that, it claims, prevents the informal sector from paying its fair share of taxes.[6]

The taxation of the informal sector has a number of links, at least tangentially, with a broader global tax justice movement. High-profile discoveries such as the 'Panama Papers', growing levels of inequality and a general desire for greater accountability have focused attention on issues of fairness and equity in taxation (Keen 2008, 2012; Sampere 2018). However, for many informal workers across the global South, concerns with the proliferation of tax havens, tax breaks or tax rebates granted to large multinational companies are far removed from the realities of their daily experiences with taxation (Sampere 2018). Nevertheless, tax is a critical issue for those working in the informal economy and particularly for those in the informal sector. It is this particular group of workers, the self-employed in the informal sector (that is, informal enterprises), that have been the target of new tax policy proposals to improve revenue collection in a number of countries.

Such efforts have raised questions concerning the effectiveness of increases in local levels of taxation or attempts to introduce national taxes for informal workers, but have also drawn attention to broader issues of state–society relations, accountability and the social contract. In the same way that conceptualisations of the social contract have been based on assumptions of full formal (and male) wage employment, the understanding of taxation as the instrument through which the social contract is negotiated is based, at least implicitly, on the so-called 'standard' employment relationship. The fact that this condition has very little relevance to the dominant forms of employment in the global South has introduced an obvious source of tension between modes of taxation and the strengthening of the social contract in developing-country contexts.

This chapter aims to examine the social contract through the lens of informal sector taxation. In so doing, it sets out to identify some of the systemic failures, theoretical blind spots and unequal power relationships which limit the possibilities of strengthening the social contract through taxation. The remainder of the chapter is structured as follows. The first section offers a broad overview of some of the current models of informal sector taxation and outlines several key concepts. The next section makes an explicit link between taxing the informal sector and the social contract by reviewing a number of recent theoretical and empirical claims. Several critiques of these claims, embodied within the 'new fiscal sociology', are then considered. In support of these critical perspectives, a number of well-documented challenges to strengthening governance and accountability through taxation are then discussed in this section. Finally, the chapter concludes by reflecting on a case study of informal street vendors and market workers in Accra, Ghana. The ensuing discussion considers how some of the perspectives of the new fiscal sociology, which theorise the strengthening of the social contract through taxation, sit in tension with the realities experienced by informal workers in the global South.

THE INFORMAL SECTOR: CURRENT MODELS AND KEY CONCEPTS

Before proceeding to an analysis of the links between taxation and the social contract, some context is required. On the whole, it is difficult to establish a clear picture of the scope and scale of informal sector taxation at a global or even regional and national levels. This challenge stems from the fact that informal sector taxes and (tax-like) fees are often levied at the local (city) level, because these taxation regimes are often lacking in transparency, and because enforcement and implementation are often uneven. Similarly, there is very little information on how much informal workers contribute to local finances. At least part of the reason is because the fees and taxes that workers pay come in many different forms and are not accounted for in a way which is reflected in municipal budgets or audit reports. Their contributions are likely to be substantial, however, and as one example from Ghana suggests, 'market revenues, in the form of fees and stall rents, are of considerable importance for local governments – as they have been historically (Clark 2010) – representing an average of 27 per cent and 24 per cent of local government tax revenue from 2001 to 2011' (Prichard and van den Boogaard 2015: 10).

The challenges with identifying the scale of informal sector taxation notwithstanding, it is possible, in broad terms, to outline some of the key concepts and features. As a starting point, the literature on development and taxation often refers, somewhat problematically, to the 'hard to tax' or the 'shadow economy' to describe components of the labour force that should/could be targeted by tax administrators in developing and transition countries (Schneider and Enste 2000, Bird and Wallace 2003). While the 'hard to tax' and the shadow economy often overlap in some contexts, there is a clear distinction between, on the one hand, firms and individuals that earn enough to pay taxes but do not and, on the other hand, firms and individuals which are often very small earners and are potentially, but not necessarily, taxable. This latter category includes most groups of urban informal workers (for example, waste pickers, street vendors and home-based workers) across the global South. The reality for these groups is that they may fall between the categories of 'hard to tax' and the untaxable both because the administrative costs of taxing them are high and because their earnings fall below official tax thresholds (Bird and Wallace 2003). In many countries across the developing world, such workers make up the vast majority of the workforce and earn well below their national income tax thresholds (Pimhidzai and Fox 2013).

There are also some important distinctions within the different segments of the informal economy. Informal employees (both inside and outside the informal sector), for example, are liable for income taxes if they earn above their country's income tax threshold (although many do not). In the case of informal employees in informal enterprises, many are among the 'working poor' and earn below the tax threshold The same logic applies to domestic workers in that, even if registered by their employers for national tax purposes, their earnings are likely to be too low to be taxable. However, employees in the informal economy (both inside and outside of the informal sector) typically pay indirect or consumption taxes on the goods that they purchase.

The informal workers with which this chapter is concerned are the self-employed in the informal sector. This is the group of workers which is most often targeted for tax contributions by developing-country governments. The focus of this chapter is, therefore, on tax policies related to the informal sector and, in particular, those which are relevant to informal employers and own-account workers. The mechanisms for taxing this specific group of workers include (Joshi et al. 2014): indirect taxation (examples include value-added tax – VAT – and import duties) as well as several types of direct taxation on informal sector incomes. While methods of indirect taxation have, arguably, the widest reach and are often seen as the most efficient ways to 'capture' the informal sector, they are not the focus of this chapter. There is a separate literature on the effects of indirect taxes such as VAT on tax efficiency and equity in developing countries, but these debates are often not specific to the informal sector (but see Valodia and Francis 2020). Moreover, the new generation of tax policy proposals in developing-country contexts is focused on the direct taxation of the self-employed in the informal sector.

There are several forms of direct taxation that are often levied against the informal self-employed, but perhaps the most common is presumptive taxation. As suggested by the name, this particular tax system is comprised of setting uniform fixed amounts of tax based on the 'presumed' incomes of different occupations. In Zimbabwe, for example, presumptive taxation is based largely on the sector of activity and a tax schedule reflects different tax rates for, inter alia, informal traders, hairdressers, taxi drivers and small-scale miners. In Tanzania, taxes are implemented through a 'block management system' which is used to monitor informal activities in areas associated with high levels of informal trading. Tax officials encourage traders in these areas to keep financial records, and tax rates are lower for traders that can produce such records. Otherwise, taxes are levied against 'presumed' turnover based on identifiable characteristics of the enterprise as determined by a tax commissioner (see Dube and Casale 2016). Such presumptive tax systems are appealing because they are simple to administer, do not require access to business accounts and can be publicised to wide segments of the population (see Prichard 2009, Dube 2014, Dube and Casale 2016, Dube and Casale 2017, Mekonnen Workneh et al. 2019). Proponents of presumptive taxes have argued that '[they] may well be the most appropriate solution for many developing countries with large informal sectors. A single tax is particularly useful in countries with numerous small "nuisance" taxes, and if well-administered, is likely to have a strong signalling effect encouraging informal entrepreneurs to become compliant' (Loeprick 2009: 6).

Other common forms of direct taxation of the informal sector which have been implemented in developing countries at the local level include: various types and methods of taxation on transport operators, tax stamp programmes for informal traders and a flat rate tax on retail turnover (Prichard 2009). Market taxes (for example, in Ghana) are another good example of a direct tax, and have become popular due to their high visibility and associated potential to promote 'citizen engagement' and tax negotiation (Prichard and van den Boogaard 2015). These taxes are typically levied as fees for operating as traders or in designated market areas. Market taxes have even prompted some cities in the global South (see Akeju 2018) to explore the role of using market associations and informal worker organisations as agents of tax collection.

In short, there has been an enduring interest in increasing informal sector contributions to national and local coffers through a series of direct taxation measures. While indirect taxes are increasingly a key feature of tax systems in the global South and many informal workers do pay these taxes, some of the more prominent debates concerning taxation of the informal sector are focused on methods of direct taxation.

INFORMAL SECTOR TAXATION AND THE SOCIAL CONTRACT

The motivations for taxing the informal sector can be grouped into a number of different rationales (see IMF 2011, Joshi et al. 2013). Perhaps first and foremost, proponents (Schneider and Klinglmair 2004, Schneider et al. 2010) of informal sector taxation often point to the large potential revenues associated with the informal sector in many developing countries. In contexts with relatively small tax bases, the need to finance relief packages to address the economic damage caused by the COVID-19 pandemic is likely to place increased pressure on national tax agencies to 'find' new sources of revenue (Gallien et al. 2021).

Revenue-based arguments for taxing the informal sector are the most common in the tax literature and are concerned with the 'potential income' that could be raised by bringing the informal self-employed and their employees (if any) into the tax net. This argument is typically (either explicitly or implicitly) applied in relation to the payment of taxes to the *national* tax authority while informal sector workers are more likely to being paying *local* taxes and fees (Pimhidzai and Fox 2013).

While the main arguments for taxing the informal sector are underpinned by these fiscal and regulatory considerations (see Rogan 2019), a new perspective in the development literature has begun to espouse the link between informal sector taxation and good governance or the so-called 'governance dividend' (Moore 2008, 2015; Meagher 2016). Relatedly, one of the most prominent arguments, particularly outside of the conventional tax and economics literatures, for taxing the informal sector is to repair or to establish the social contract (Resnick 2018). This section of the literature (Levi 1988, Tilly 1990, Brautigam 2002, Moore 2008, Prichard 2015) has argued that bringing more citizens into the tax net promotes a more inclusive ownership of government resources and activities – thereby improving the ability of workers to make claims on the state. Broadly termed 'the new fiscal sociology' (Keen 2012), a number of recent approaches to the informal sector within the development agenda include attempts to 'draw the informal economy into the tax net with a view to rebuilding the social contract that was demolished under structural adjustment' (Meagher and Lindell 2013: 59). Crucially, these new approaches have moved beyond 'taxation as formalisation' where the principal goal was to bring unregistered enterprises into the tax net (see Dube and Casale 2016). Instead, the benefits of taxation to both workers and state–society relations are emphasised. As a parallel process, the formalisation of the informal sector (embodied within the International Labour Organization's Recommendation 204) is framed as a progressive realisation of rights, where formalisation is not simply a series of registration and tax measures but also includes the benefits of compliance.

In particular, there are three channels through which informal sector taxation is hypothesised to strengthen the social contract. First, the state, in aiming to encourage tax compliance, may actually become more responsive to tax paying groups. In the most optimistic view, taxation then becomes 'a catalyst for the development of responsive and accountable government' (Prichard 2010: 9). Second, citizens may be more likely to make claims against the state if they have contributed taxes. Third, tax collection in the informal sector may encourage informal workers to engage in collective action through their worker-based organisations – with the knock-on effect of greater bargaining with the state (Joshi et al. 2014).

The social contract argument for taxing the informal sector also has a 'reciprocity' component which, through the 'fiscal exchange hypothesis', suggests that citizens are more likely to be tax-compliant when they can observe tangible benefits (for example, the provision of services) as a result (Bodea and Lebas 2013, 2014; Resnick 2018). There is some evidence from Zambia (Resnick 2018) that having greater access to services and infrastructure in informal markets is correlated with a higher likelihood of paying taxes (see also Korsun and Meagher 2004, Bodea and Lebas 2014). However, even when there is evidence of a link between taxation and greater government accountability and service delivery, the relationship is mediated by factors such as the broader state of politics, the role of elites, the mobilising capacity of civil society and 'the motives for the tax increase and the type of tax in question' (Prichard 2009: 1). These are factors which are likely to be particularly relevant when taxing the informal sector.

More broadly, while taxation is clearly a key element of state- and institution-building, there is an ongoing debate about what this means precisely for tax policy in a developing-country context (IMF 2011). One of the key questions, for example, is whether informal sector taxation 'strengthens public accountability or [whether it simply] creates new avenues of predation' (Meagher and Lindell 2013: 67). In answering this question based on research in Nigeria, Meagher (2016) suggests that taxing the informal sector has tended to promote social divisions rather than restoring the social contract. One of the key lessons emerging from this work in Nigeria is that the social contract is shaped by the historical fiscal relationship between the state and the citizenry. Thus there is no all-encompassing model of a social contract which can be enhanced through greater levels of taxation. Another key lesson is that taxation in and of itself does not necessarily create the political capacity (for example, among associations of informal workers) that is required to effect engagement between the state and society – particularly in contexts where levels of trust and accountability are low. In such contexts, the building of the social contract has an obvious relevance, if not urgency, but, on the whole, it appears as though some of the key issues surrounding informal sector taxation and the social contract require further interrogation.

CHALLENGING THE NEW FISCAL SOCIOLOGY

One of the assumptions in much of the tax literature (Emran and Stiglitz 2005, Torgler and Schneider 2007, Bird and Zolt 2008) is that informal sector workers (firms) are tax evaders. The reality, however, is that micro-informal firms are not tax evaders because they tend to fall below the earnings thresholds set by central or national tax agencies and because they already pay various types of taxes and operating fees at the local level (Pimhidzai and Fox 2013). Even one of the most important intellectual breakthroughs in relation to taxation (the 'new fiscal sociology') somewhat inadvertently has tended to downplay these contributions in an effort to focus more attention on the institution of taxation as a window into the changing social contract (see Martin et al. 2009a, 2009b). The new fiscal sociology's assertion that 'taxpayer consent is best explained not as coercion, predation or illusion, but as a collective bargain in which taxpayers give up resources in exchange for collective goods that amplify the society's productive capacities' appears to embrace a somewhat narrow view of the mechanisms of taxation particularly as they relate to different forms of tax (Martin et al. 2009b: 14). Moreover, the claim that 'in the modern world, taxation *is* the social contract' (Martin 2009b: 1, emphasis in the original) or, more specifically, that it is 'the actually existing social contract, the renegotiation of which transforms the relationship between state and society' (Martin et al. 2009b: 26) suggests a particularly rigid and narrow understanding of the forms of taxation as they may apply to the informal sector in developing country contexts.

Accordingly, Meagher (2016: 3) identifies three 'blindspots' in the new fiscal sociology literature as it applies to informal sector taxation and improved governance, which include: '(1) the use of historically inappropriate (and Euro-centric) models of the social contract, (2) a propensity to "fiscal essentialism" in the definition of informality, and (3) a monolithic view of the informal economy'. In challenging some of the claims from the new fiscal sociology, her work has shown that through payment of a range of fees, licenses, market levies and registration dues, workers in the informal sector are far from 'tax evaders' (Meagher 2016). In fact, it is the way in which the new taxation literature tends to ignore the many ways in which informal workers pay taxes (including bribes) that Meagher refers to as 'fiscal essentialism' (Meagher 2016). Moreover, tax collection (including illicit taxation through bribes) is generally uneven in the informal sector, and more vulnerable workers, in particular, have less leverage to negotiate and/or enforce their rights (Meagher 2016).

In one widely cited example from Uganda, the data suggest that, 'contrary to widely held perceptions, microenterprises pay taxes – albeit not to the central government but to local governments in various fee payments'. In reaching a similar conclusion to Meagher (2016), Pimhidzai and Fox (2013: 3) also note that, in the Ugandan case study, 'the least noticed sector with the softest voice ends up paying a disproportionate tax burden' (Pimhidzai and Fox 2013: 3):

> [These] taxes paid are in various forms. They include tax payments to the central government in the form of VAT and income tax, either corporate tax or a presumptive/small businesses tax as dictated by their turnover. Tax payments are also made to the local governments in the form of trading license fees, operating permit fees, cess on produce (a levy paid by agriculture commodity traders) and user fees like market dues (Pimhidzai and Fox 2013: 7).
>
> Thus nano-enterprises are not necessarily tax evaders if they do not pay any taxes at the national level. Rather, they pay taxes and fees elsewhere (Pimhidzai and Fox 2013: 10).

The unacknowledged and unequal power relations that influence compliance with tax codes and by-laws and the multiple and often regressive sources of taxation and the burden they place on informal workers all sit in tension with the key tenets of the new fiscal sociology. Therefore, its limits in examining the social contract between the state and workers in the informal sector require a rethink about the modes of exploitation which are experienced in cities across the global South. In these contexts, multiple forms of taxation place an unfair burden on the poorest workers in the informal sector and may, in fact, damage the social contract between the worker and the state.

REGRESSIVE TAXATION AT THE BOTTOM OF THE ECONOMIC PYRAMID

Even when the taxes that informal workers do pay are recognised, the existing evidence suggests that they are often highly regressive (that is, they violate the principle of vertical equity).[7] In many countries in sub-Saharan Africa (including Ethiopia, Kenya, Rwanda, Tanzania and Zimbabwe) and Latin America, presumptive tax regimes (for a flat rate system, see Meagher 2016) have become popular methods with which to collect taxes from the self-employed (Joshi et al. 2014, Dube and Casale 2017, Getachew 2019). Such tax systems, however, also violate the principle of horizontal equity since there is no minimum income threshold. As a result, workers in the formal sector who earn similar amounts could pay less in taxes than their counterparts in the informal sector (Dube and Casale 2017; see also Pimhidzai and Fox 2013).

Moreover, compared with corporate income taxes, presumptive tax regimes do not allow the types of deductions which are available to formal firms (while, at the same time, informal firms are often exposed to fees and other types of costs not normally paid by formal operators) (Dube and Casale 2017). In terms of local government taxation, evidence from Uganda showed that roughly two-thirds of small informal firms (many of which were single-person operations or family units) paid at least one type of local fee and, most crucially, the effective tax rate based on these fees was highly regressive (Pimhidzai and Fox 2013). The analysis suggested further that such regressivity means that a rise in taxes could 'threaten the viability of the smallest enterprises and push people into poverty' (Pimhidzai and Fox 2013: 1).

Related directly to the social contract is the finding that informal workers are not necessarily opposed to paying local (or even national) taxes. Far from being tax evaders, they are often willing to contribute to local revenues if the taxes are fair and transparent and if they get benefits in return:

> [Informal] businesses need the support of local government officials to survive and be sustainable. For example, within zoning and land use planning exercises, they need to be assigned workplaces such as markets and areas where small manufacturers can cluster. They need these workplaces to be supplied with basic infrastructure services such as water supply, drainage, solid waste disposal, road maintenance, streetlights as well as security. While no business wants to pay taxes, some would be ready to pay taxes to support such development if the system was perceived as fair, and benefitting them (Pimhidzai and Fox 2013: 21).

In addition to multiple and regressive over-taxation in the informal sector, there is a risk, as Meagher (2016) has suggested, that efforts to tax informal workers tend to open up 'new avenues of predation'. Harassment is more likely to happen in the informal sector because informal operators are more likely to have their fees and taxes collected in person and/or at their place of work (Resnick 2018). At times, the collection of taxes is overtly political and features

> unofficial tax exemptions [that] have been used as a means of political or social inclusion or exclusion, for example by discriminating against "out-groups" such as foreigners or migrants (e.g. Flynn 1997, Juul 2006, Schomerus and Titeca 2012, Titeca and Kimanuka 2012, Meagher 2013). More broadly, it is frequently the weakest actors who are vulnerable to extortion, while more powerful actors are able to collude with tax collectors to avoid taxes (Prichard and van den Boogaard 2015: 9).

Even where predation or extortion are not evident, limited capacity at the local government level often provides a challenge to fair tax practices. One of the key suggestions in the recent literature is, therefore, that 'more effective reform can likely be achieved by "working with the grain" of local governance realities, by seeking to design reform in a way that is consonant with inescapable capacity constraints and the broader social reality in which collection efforts are embedded' (Prichard and van den Boogaard 2015: 6). Many efforts at reforming or expanding local government tax collection tend to simply ignore the complexities of this level of taxation (Prichard and van den Boogaard 2015). In such cases, the limits to the repair of the social contract between informal workers and the state are clear.

A CASE STUDY OF INFORMAL WORKERS FROM A MARKET IN ACCRA: TAXATION WITHOUT RECIPROCITY

The chapter now reflects on the results of an exploratory research project which aimed to investigate local taxation in the informal economies of several cities in the global South.[8] The project began in Ghana, where Women in Informal Employment: Globalizing and Organizing (WIEGO) has a number of partners as well as ongoing collaborations with membership-based organisations of urban informal workers. Ghana has long been a focus for research on informal employment and, even by regional standards, the country has a large informal sector and a low tax-to-GDP (gross domestic product) ratio (Danquah and Osei-Assibey 2016). In terms of tax policy, the Ghana Revenue Authority has experimented with different ways (for example, through the introduction of the 2004 stamp tax) of bringing the informal sector into the tax net (Amponsah and Adu 2017). While the stamp tax has been, arguably, the most high-profile (and controversial) informal sector tax reform, the large non-farm informal sector has provided opportunities for many types of fees, licences and permits to be levied against the informal self-employed (Prichard and van den Boogaard 2015: 10).

In early 2018, WIEGO researchers undertook a small (n=214) survey of informal street vendors, market traders and market porters (*kayayei*) in the capital city of Accra. The questionnaire was based on a recent module on tax perceptions designed by the Afrobarometer[9] survey project. While the survey was by no means representative of the workforce, the results serve as a useful illustration of why it is important to understand the structure of local tax regimes. As suggested in Figure 4.1 below, most informal workers in the sample pay some type of fee or tax to the local government authority (the Accra Metropolitan Assembly; AMA). The two most common are the daily tax (paid by 43 per cent of respondents) and licence fees (54 per cent). All told, and similar to findings from research in Uganda (Pimhidzai and Fox 2013), the majority of workers (roughly 61 per cent) pay some type of fee or tax to the AMA in order to carry out their livelihoods. While only a handful reported paying a tax directly on their income, relatively few workers are exempt from multiple sources of taxation.

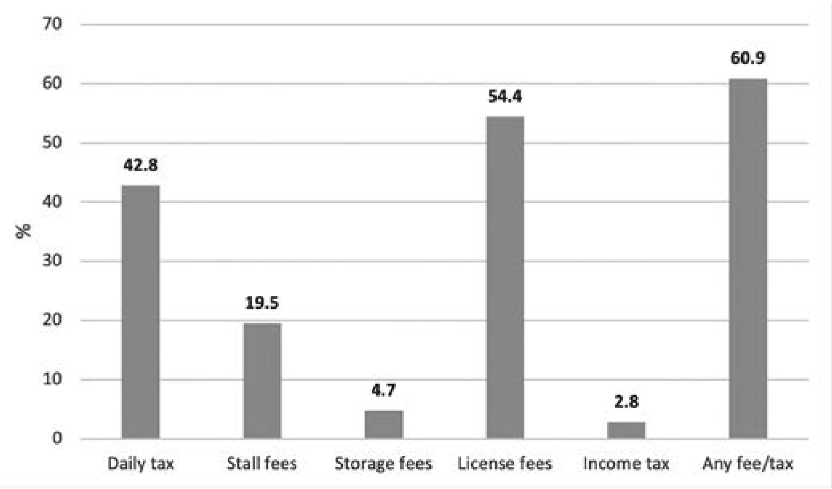

Figure 4.1 Types of taxes and fees paid by informal workers in Accra, Ghana

The main problem arises in relation to the distribution of these local taxes and fees. In Figure 4.2, the effective tax rates are presented for each worker income quintile. 'Effective tax rates', in the language of taxation, refer to total taxes paid as a percentage of total gross (monthly) income. The first quintile represents the lowest earners and the fifth represents the highest earners. When a tax regime is progressive, the effective tax rate increases (or at least does not decrease) for each quintile or, in other words, tax rates are highest among higher earners. As can be seen in Figure 4.2, this is the opposite of what happens when local tax rates are calculated for this small sample of informal workers in Accra.

While the median effective tax rate is zero for the lowest earners (most workers in quintile 1 and quintile 2 do not pay any taxes or fees to the AMA),[10] their average tax rate is about 9 per cent. In other words, the average cost of local taxes and fees is about 9 per cent of total income for this group of workers. So, while many of the lowest earning workers do not pay any types of taxes or fees to the municipality, those that do tend to pay a higher share of their earnings. However, as income increases (moving towards quintile 5) the median and

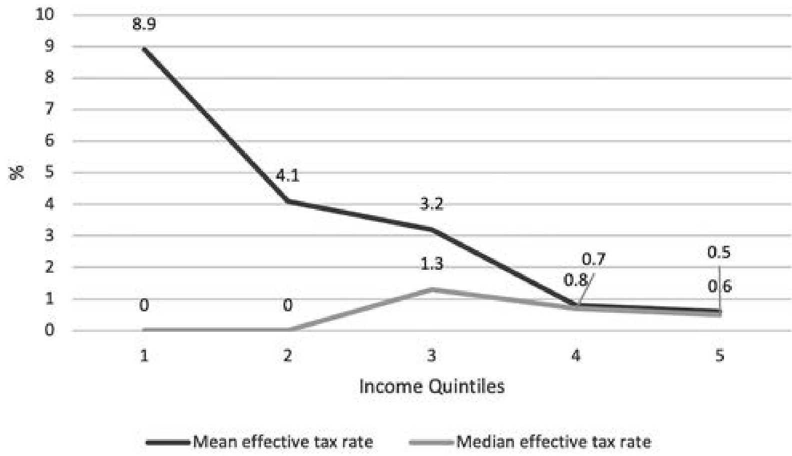

Figure 4.2 Mean and median effective tax rates by income quintile

mean tax rates converge, which suggests that the level and/or rate of tax payments is less variable. However, the key finding from the graph is that these local taxes and fees are highly regressive, with the effective tax rate decreasing steadily for each income quintile. Among the highest earners in the sample (quintile 5), the average effective tax rate is less than 1 per cent. This is a clear violation of the principle of vertical equity.

Given this existing structure of regressive local taxes, what would happen if a presumptive tax or indirect tax (for example, VAT or custom duties) was introduced to bring more informal workers into the (national) tax net? If the illustration from Accra represents a typical tax structure, then this means that even a well-intentioned tax reform would exacerbate the regressive and unfair system of taxation which exists at the local level for many informal workers. Efforts to tax the informal economy would be borne by the poorest groups of informal workers – many of whom are women.[11]

Since taxation is not simply a technical exercise related to revenue mobilisation, the perceptions of informal workers as taxpayers are also important to understand. Deriving from the exchange hypothesis which holds that citizens (and workers) are more likely to pay taxes when they receive something in exchange (for example, services, infrastructure), efforts to measure attitudes towards taxation are increasingly becoming part of the tax research agenda. The comparison (Figure 4.3) between responses to the original[12] Afrobarometer survey with those from three types of workers in Accra (market traders, street vendors and market porters) offers some interesting insights into taxation in the informal sector. When asked whether it would be better to pay high taxes in return for more public services or low taxes even if it means fewer services provided by government, most (63 per cent) of the workers that were interviewed opted for lower taxes. In contrast, about 60 per cent of the respondents to the Afrobarometer survey indicated that they would prefer *higher* taxes if it meant better public resources.

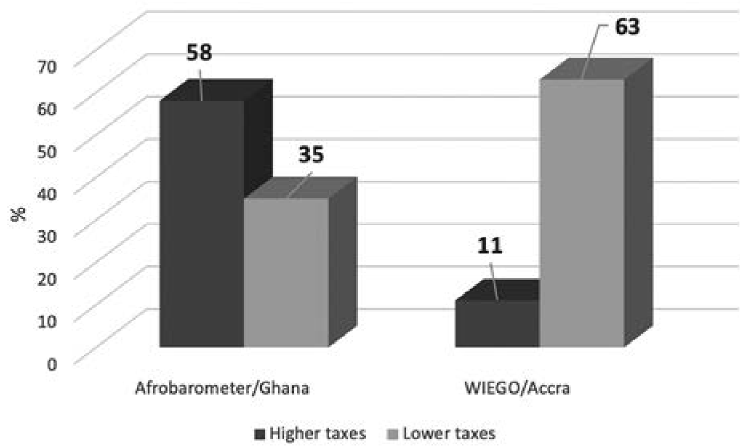

Figure 4.3 Reported preference for high vs low taxes

Informal workers' views on taxes appear to differ substantially from those held by other citizens. One possible explanation, albeit a speculative one, is that the benefits of paying taxes are less obvious and less guaranteed relative to the Afrobarometer sample. On the one hand, informal workers in Accra reported that it is relatively easy to find out which taxes and fees they are required to pay to local government (the AMA). Only about 43 per cent reported that it is difficult or very difficult to find out what taxes and rental fees they are supposed to pay. In comparison, about 70 per cent of Ghanaians who participated in the Afrobarometer survey reported difficulty in finding out what taxes or fees they are supposed to pay. The telling finding here is the large difference in the perceived transparency in how the AMA *uses* the revenues from these fees and taxes. Most informal workers (66 per cent) reported that it is difficult or very difficult to find out how the AMA actually uses the revenues from their taxes and fees. Compared to other citizens, it seems as though informal workers overwhelmingly find it difficult to see how their contributions to local government revenues are used.

Reasons for non-compliance (Figure 4.4) also reveal an important part of the story. In the Afrobarometer survey, the single largest reason for not paying taxes was that they are too high. Among the workers in the WIEGO sample, the modal response was poor service delivery (29 per cent). A relatively large percentage (25 per cent) also indicated that they could not afford to pay their taxes and fees. Combining this finding with the one from the previous graph, it seems as though informal workers in the sample do not see clear benefits deriving from their tax contributions. This, in itself, is not altogether surprising (since attitudes towards taxation can be negative for a number of reasons), but the fact that attitudes towards taxation seem more negative among informal workers than among the population as a whole is telling.

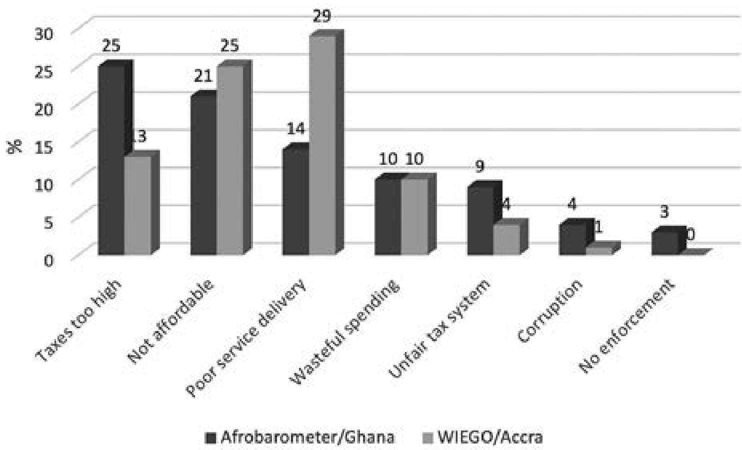

Figure 4.4 Reported reasons for tax non-compliance

THE LIMITS TO STRENGTHENING THE SOCIAL CONTRACT THROUGH TAXATION IN THE INFORMAL ECONOMY

Aligning with the objectives of this volume, the analysis in this chapter has aimed to identify systemic failures as well as a number of theoretical and empirical blind spots associated with the links between informal sector taxation and the strengthening of the social contract. Perhaps the two key themes emerging from the overview of the literature and the findings from a case study in Ghana are that: (1) the assumptions concerning the channels through which taxation leads to good governance are not well defined and tend not to align well with the realities of informal employment, and (2) the lack of recognition of informal workers and the contributions that they already make to local governments does not create a fertile environment for a vibrant social contract.

In short, the lack of responsiveness and reciprocity which characterise local tax regimes in cities across the global South are not currently conducive to governance, accountability or the strengthening of the social contract.

However, the perspectives put forth in this chapter are not intended to suggest that there are no circumstances under which (even regressive) taxation can strengthen the social contract or improve the governance dividend. As suggested by Moore (2015), it is possible for governments that levy regressive taxes in lower-income countries to compensate for the uneven tax burden through (targeted) public spending. Rather, the argument here has been that the tax and development literature has applied too narrow a lens on the structures, institutions and practices of taxation as they apply to informal workers in the global South. Due, in part, to a lack of data (for example, on municipal finances), this literature tends to ignore the realities of taxation for the informal sector and, as such, does not meet the preconditions for imagining an alternative where workers and their organisations are participants in tax design as well as beneficiaries of taxation. Similarly, the language of taxation as the basis of the social contract does not appear to offer a comfortable fit with the institutions of taxation or the ways in which governance through taxation is realised in many developing-country contexts.

In contrast, and in imagining tax justice for the informal economy, a key principle is that of exchange or reciprocity. For example, 'there is evidence suggesting that informal sector workers are willing to pay taxes when: (a) the benefits outweigh the costs; (b) when they are sufficiently empowered; and (c) when there are effective institutional channels for facilitating collective action and bargaining to ensure they receive the benefits' (Joshi et al. 2013: 20). There is further evidence that, when investments in local infrastructure are undertaken in a transparent way which links market taxes with public expenditure, informal tax compliance increases (sometimes substantially) (Joshi et al. 2013). Thus, while there is still much to be learned about taxing the informal sector, an approach which engages directly with informal workers and their organisations is likely to be the best way to ensure a fair system of taxation which maximises local revenues while supporting livelihoods in the informal sector. In this regard, perhaps the notion of 'associational taxation' where organisations representing informal workers are involved directly with the formation of tax policy is the most promising (see Joshi and Ayee 2008). Some (albeit limited) examples of the way in which reciprocity can lead to effective negotiation between workers and the state have been reported in Ghana, Senegal and Peru (Roever 2006, Joshi and Ayee 2008).

However, in order to achieve the aim of developing fair and transparent tax systems for informal workers, more research is needed. In particular, the question that drives such a research agenda might best be reframed as, 'under what conditions or circumstances could governance gains be achieved in relation to informal sector taxation and the social contract?' (see Joshi et al. 2014). Underlying this question is, of course, the broader issue of whether it is, in fact, possible for 'taxation [to] become a source of healthy conflict between [informal workers] and the state' (Moore 2008: 35). Addressing these questions requires a careful analysis of existing tax systems and an acknowledgment of the contributions that are made by informal workers in the countries of the global South (both to revenues and to local economies). While there remain a number of questions, both empirical and theoretical, at present a focus on reciprocity as the means to explore the social contract between the state and the bulk of the workforce in the global South appears to be the most logical starting point.

NOTES

1. This inter-disciplinary approach attempts, inter alia, to address Schumpeter's classic set of questions about tax – namely 'the social sources of tax systems, the determinants of taxpayer consent, and the social and cultural consequences of taxation' (Martin et al. 2009b: 14).
2. The analysis in this chapter is concerned specifically with the informal sector. The informal sector is a sub-set of the informal economy and includes all types of employment (for example, self-employment, employees and unpaid contributing family workers) in unregistered or unincorporated enterprises.
3. While not explicitly aiming to widen the tax next, the CAPBSS recovery package is being implemented against the backdrop of the Ghana Beyond Aid strategy document (see Office of the Presidency 2019, p. 37) which aims to, inter alia, 'find innovative ways to widen our tax net and to bring in the huge informal sector'.
4. While official information on this recovery package is difficult to source, it is managed by the National Board for Small Scale Industries, which is an agency under the Ministry of Trade and Industry mandated by Act 434 to promote and develop micro, small and medium-sized enterprises in Ghana.
5. In some respects, however, this is a false equivalence as the structure of the economy in developing countries is very different to high-income countries. Most developing countries with low tax-to-GDP (gross domestic product) ratios, for example, also have low per capita incomes, a low ratio of international trade to GDP and high levels of agricultural activity (Moore 2015).
6. See: www.ghana.gov.gh/index.php/media-center/news/5082-only-2-per-cent-informal-sector-pays-tax-gra-launches-tax-campaign.
7. In the context of taxation, 'horizontal equity' refers to the idea that different types of taxpayers with similar levels of earnings should pay the same amount in taxes. 'Vertical equity' refers to the idea that taxpayers with higher incomes should pay a higher rate of taxation.
8. The project data have not yet been published.
9. www.afrobarometer.org/.
10. In other words, only the higher earners in these quintiles pay any taxes but, overall, average tax rates are high.

11. Women often earn less in the informal economy, a situation that would then be exacerbated by a flat tax (see, for example, Rogan and Alfers 2019).
12. The Afrobarometer interviewed a nationally representative sample of 2,400 respondents in Ghana in 2017.

REFERENCES

Akeju, K.F. (2018), 'Informal Sector and Tax Compliance: The Role of Associational Membership in South West, Nigeria', *International Journal of Applied Economics, Finance and Accounting*, **3** (1), 1–9.

Amponsah, S., and K.O. Adu (2017), 'Socio-Demographics of Tax Stamp Compliance in Upper Denkyira East Municipal and Upper Denkyira West District in Ghana', *International Journal of Law and Management*, **59** (6), 1315–1330.

Bird, R., and S. Wallace (2003), *Is It Really So Hard to Tax the Hard-to-Tax? The Context and Role of Presumptive Taxes*, ITP Paper No. 0307, Toronto: International Tax Program, University of Toronto.

Bird, R., and E. Zolt (2008), 'Tax Policy in Emerging Countries', *Environment and Planning C: Government and Policy*, **26**, 73–86.

Bodea, C., and A. Lebas (2013), *The Origins of Social Contracts: Attitudes toward Taxation in Urban Nigeria*, CSAE Working Paper No. WPS/2013–02, Oxford: Centre for the Study of African Economies.

Bodea, C., and A. Lebas (2014), 'The Origins of Voluntary Compliance: Attitudes toward Taxation in Urban Nigeria', *British Journal of Political Science*, **46**, 215–238.

Brautigam, D. (2002), 'Building Leviathan: Revenue, State Capacity and Governance', *IDS Bulletin*, **33** (3), 1–17.

Clark, G. (2010), 'Gender Fictions and Gender Tensions Involving "Traditional" Asante Market Women', *African Studies Quarterly*, **11** (2–3), 43–66.

Danquah, M., and E. Osei-Assibey (2016), *Informality and the Tax Gap: A Case of Non-Farm Enterprises in Ghana*, IGC Report No. S-33206-GHA-1, London: International Growth Centre, London School of Economics and Political Science.

Dube, G. (2014), 'Informal Sector Tax Administration in Zimbabwe', *Public Administration and Development*, **34**, 48–62.

Dube, G., and D. Casale (2016), 'The Implementation of Informal Sector Taxation: Evidence from Selected African Countries', *eJournal of Tax Research*, **14** (3), 601–623.

Dube, G., and D. Casale (2017), 'Informal Sector Taxes and Equity: Evidence from Presumptive Taxation in Zimbabwe', *Development Policy Review*, doi: 10.1111/dpr.12316.

Emran, M., and J. Stiglitz (2005), 'On Selective Indirect Tax Reform in Developing Countries', *Journal of Public Economics*, **89**, 599–623.

Flynn, D. (1997), '"We Are the Border": Identity, Exchange, and the State Along the Benin-Nigeria Border', *American Anthropologist*, **24** (2), 311–330.

Gallien, M., M. Moore and V. van den Boogaard (2021), *Taxing the Informal Economy Is Not a Silver Bullet for Financing Development – Or the Covid-19 Recovery*, ICTD Summary Brief No. 24, Brighton: International Centre for Tax and Development at the Institute of Development Studies.

Getachew, A. (2019), *Turnover-Based Presumptive Taxation and Taxpayers' Perceptions in Ethiopia*, ICTD African Tax Administration Paper No. 7, Brighton:

International Centre for Tax and Development at the Institute of Development Studies.
Hamadi, R. (2020), 'Régularisation de l'informel: un chantier colossal et vital'. Algeria-Watch. https://algeria-watch.org/?p=73567.
ILO (2018), *Women and Men in the Informal Economy: A Statistical Picture*, 3rd edition, Geneva: International Labour Organization.
IMF (2011), *Revenue Mobilization in Developing Countries*, Washington, DC: International Monetary Fund.
Joshi, A., and J. Ayee (2008), 'Associational Taxation: A Pathway into the Informal Sector?', in D. Brautigam, O.-H. Fjeldstad and M. Moore (eds), *Taxation and State-Building in Developing Countries: Capacity and Consent*, Cambridge: Cambridge University Press, 183–211.
Joshi, A., W. Prichard and C. Heady (2013), *Taxing the Informal Economy: Challenges, Possibilities and Remaining Questions*, IDS Working Paper No. 429, Brighton: International Centre for Tax and Development, Institute of Development Studies.
Joshi, A., W. Prichard and C. Heady (2014), *Taxing the Informal Economy: The Current State of Knowledge and Agendas for Future Research*, *Journal of Development Studies*, **50** (10), 1325–1347.
Juul, K. (2006), 'Decentralization, Local Taxation and Citizenship in Senegal', *Development and Change*, **37** (4), 821–846.
Keen, M. (2008), 'VAT, Tariffs, and Withholding: Border Taxes and Informality in Developing Countries', *Journal of Public Economics*, **92**, 1892–1906.
Keen, M. (2012), *Taxation and Development – Again*, IMF Working Paper No. WP/12/220, Washington, DC: International Monetary Fund.
Korsun, G., and P. Meagher (2004), 'Failure by Design? Fiscal Decentralization in West Africa', in M. Kimenyi and P. Meagher (eds), *Devolution and Development: Governance Prospects in Decentralizing States*, London: Routledge, 137–195.
Kundt, T. (2017), *Opportunities and Challenges for Taxing the Informal Economy and Subnational Taxation*, K4D Emerging Issues Report, Brighton: Institute of Development Studies.
Levi, M. (1988), *Of Rule and Revenue*, Berkeley, CA: University of California Press.
Loeprick, J. (2009), *Small Business Taxation: Reform to Encourage Formality and Firm Growth*, Practice Note No. 48313, Washington, DC: World Bank.
Martin, I., A. Mehrotra and M. Prasad (2009a), *The New Fiscal Sociology: Taxation in Comparative and Historical Perspective*, Cambridge: Cambridge University Press.
Martin, I., A. Mehrotra and M. Prasad (2009b), 'The Thunder of History: The Origins and Development of the New Fiscal Sociology', in I. Martin, A. Mehrotra and M. Prasad (eds), *The New Fiscal Sociology: Taxation in Comparative and Historical Perspective*, Cambridge: Cambridge University Press, 1–28.
Meagher, K. (2013), 'Informality, Religious Conflict, and Governance in Northern Nigeria: Economic Inclusion in Divided Societies', *African Studies Review*, **56** (3), 209–234.
Meagher, K. (2016), 'Taxing Times: Taxation, Divided Societies and the Informal Economy in Northern Nigeria', *Journal of Development Studies*, doi: 10.1080/00220388.2016.1262026.
Meagher, K., and I. Lindell (2013), 'ASR Forum: Engaging with African Informal Economies – Social Inclusion or Adverse Incorporation?', *African Studies Review*, **56** (3), 57–76.
Mekonnen Workneh, A., E. M. Baileyegn and G. Stewart-Wilson (2019), *Where the Gap Lay: Presumptive Income Tax Assessment for Small and Micro Enterprises*

in Addis Ababa City Administration, ICTD Working Paper No. 94, Brighton: International Centre for Tax and Development at the Institute of Development Studies.

Moore, M. (2008), 'Between Coercion and Contract: Competing Narratives on Taxation and Governance', in D. Brautigam, O.H. Fjeldstad and M. Moore (eds), *Taxation and State-Building in Developing Countries: Capacity and Consent*, Cambridge: Cambridge University Press, 34–63.

Moore, M. (2015), *Tax and the Governance Dividend*, ICTD Working Paper No. 37, Brighton: International Centre for Tax and Development.

Office of the Presidency (2019), *Ghana Beyond Aid Charter and Strategy Document*, Ghana.

Pimhidzai, O., and L. Fox (2013), *Taking from the Poor or Local Economic Development: The Dilemma of Taxation of Small Informal Enterprises in Uganda*, Washington, DC: World Bank Group.

Prichard, W. (2009), *The Politics of Taxation and Implications for Accountability in Ghana 1981–2008*, IDS Working Paper No. 330, Brighton: Institute of Development Studies, University of Sussex.

Prichard, W. (2010), *Taxation and State Building: Towards a Governance Focused Tax Reform Agenda*, IDS Working Paper No. 341, Brighton: Institute of Development Studies, University of Sussex.

Prichard, W. (2015), *Taxation, Responsiveness, and Accountability in Developing Countries: The Dynamics of Tax Bargaining*, New York, NY: Cambridge University Press.

Prichard, W., and V. van den Boogaard (2015), *Norms, Power and the Socially Embedded Realities of Market Taxation in Northern Ghana*, ICTD Working Paper No. 30, Brighton: International Centre for Tax and Development, Institute of Development Studies.

Resnick, D. (2018), *Tax Compliance and Representation in Zambia's Informal Economy*, IGC Working Paper No. S-41418-ZMB-1, London: International Growth Centre, London School of Economic and Political Science.

Roever, S. (2006), 'Enforcement and Compliance in Lima's Street Markets: The Origins and Consequences of Policy Incoherence toward Informal Traders', in B. Guha-Khasnobis, R. Kanbur and E. Ostrom (eds), *Linking the Formal and Informal Economy: Concepts and Policies*, Oxford: Oxford University Press, pp. 246–262.

Rogan, M. (2019), *Tax Justice and the Informal Economy: A Review of the Debates*, WIEGO Working Paper No. 41, Manchester: Women in Informal Employment: Globalizing and Organizing.

Rogan, M., and Alfers, A. (2019), 'Gendered Inequalities in the South African Informal Economy', *Agenda*, **33** (4), 91–102.

Sampere, K. (2018), *Tax Unrest among Market Traders: The Local Side of ActionAid's International Tax Justice Campaign in Nigeria*, ICTD Working Paper No. 80, Brighton: International Centre for Tax and Development at the Institute of Development Studies.

Schneider, F., A. Buehn and C. Montenegro (2010), *Shadow Economies All over the World: New Estimates for 162 Countries from 1999 to 2007*, World Bank Policy Research Working Paper No. 5356, Washington, DC: World Bank.

Schneider, F., and D. Enste (2000), 'Shadow Economies: Size, Causes, and Consequences', *Journal of Economic Literature*, **38**, 77–114.

Schneider, F., and R. Klinglmair (2004), *Shadow Economies around the World: What Do We Know?*, IZA Discussion Paper No. 1043, Bonn: Institute of Labour Economics.

Schomerus, M., and K. Titeca (2012), 'Deals and Dealings: Inconclusive Peace and Treacherous Trade Along the South Sudan-Uganda Border', *Africa Spectrum*, **47** (2–3), 5–31.

Tilly, C. (1990), *Coercion, Capital, and European States, A.D. 990–1992*, New York, NY: Wiley-Blackwell.

Titeca, K., and C. Kimanuka (2012), *Walking in the Dark: Informal Cross-Border Trade in the Great Lakes Region*, London: International Alert.

Torgler, B., and F. Schneider (2007), *Shadow Economy, Tax Morale, Governance and Institutional Quality: A Panel Analysis*, IZA Discussion Paper No. 2563, Bonn: Institute for the Study of Labor.

Valodia, I., and D. Francis (2020), 'Tax and the Informal Economy: Lessons from South Africa', in M. Chen and F. Carré (eds), *The Informal Economy Revisited: Looking Back, Thinking Forward*, London: Routledge.