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The Art of Taxation

Why raising revenue is central to development

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ALL GOVERNMENTS need money. Roads must be built, schools staffed, hospitals supplied, courts funded, and public safety ensured. These public goods and services form the backbone of every well-functioning economy and society. Governments can borrow or accept foreign aid, but the most sustainable source of financing is taxation.

Raising tax revenue, however, is not simply a technical exercise. Governments must strike a careful balance. On one hand, revenues must be sufficient to finance public services and fulfill public obligations. On the other hand, taxes that are too high, poorly designed, or badly administered can stifle investment, innovation, and economic growth.

This balancing act has become more difficult. Today public debt and fiscal deficits are high in many countries, even as spending needs are rising. Populations are aging, poverty remains a concern, and governments face growing pressure to invest in education, health care, digital infrastructure, and climate resilience. This requires more public resources—yet raising revenue

without snuffing out growth is a formidable challenge.

The process by which countries seek to raise public resources through taxation in a sustainable, efficient, and equitable manner is known as *domestic revenue mobilization*. It lies at the heart of development because it determines whether governments can finance their priorities, reduce dependence on external aid, and respond to shocks effectively.

Revenue mobilization is deeply political. Decisions about who pays taxes, how much, and in what form go to the core of the social contract between the state and its citizens. Since few people like paying taxes, reform requires not only sound economic design but also careful political management. Ultimately, success depends on trust—trust that the tax system is fair and that government will use revenue wisely for the public good. That is the art of taxation.

Research suggests that a useful benchmark for countries is to generate tax revenue of at least 15 percent of GDP. Below this level, government effectiveness, financial development, and economic

growth stagnate. Yet today more than 70 developing economies still collect less than 15 percent of GDP in taxes. This constrains development and leaves governments vulnerable to economic shocks.

The good news is that many developing economies have untapped revenue potential. They could raise an additional 4 to 5 percent of GDP through well-designed tax reforms, estimates suggest. Countries including Jamaica, Maldives, Morocco, Nepal, Rwanda, and Uzbekistan have demonstrated recently that meaningful gains are possible, even in challenging contexts.

Types of tax

Over time, countries tend to move away from narrow and distortionary taxes toward those that are broader and more efficient. Historically, trade taxes such as tariffs were an important revenue source for developing economies because they were relatively easy to collect at borders. Since the mid-20th century, trade taxes have declined worldwide thanks to globalization and trade liberalization, but they still account for about one-quarter of tax revenue in many developing economies. Overreliance on tariffs, however, can discourage trade, raise consumer prices, and slow economic integration.

Modern tax systems rely more heavily on taxes on consumption, income, and wealth. Value-added tax (VAT) has become the workhorse of revenue systems around the world, generating more than one-third of total tax revenue, even in many low- and middle-income countries. VAT is relatively efficient because it taxes consumption broadly while allowing firms to deduct taxes paid on inputs, which reduces cascading effects along supply chains.

VAT is often complemented by excise taxes on goods that impose social costs, such as tobacco and alcohol, or on environmentally harmful activities, such as burning fossil fuels. These taxes can both raise revenue and improve public health or environmental outcomes.

Corporate income taxes also play an important role in developing economies, particularly as a way to tax profits of large companies and multinational corpora-

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tions. However, corporate taxation has come under pressure from international tax competition and profit shifting, where firms move profits to low-tax jurisdictions. This has made corporate tax reform increasingly complex and underscores the need for international coordination.

Personal income taxes, by contrast, typically raise relatively little revenue in developing economies. This reflects several structural factors: a small middle class, large informal sectors, widespread self-employment, and a limited formal financial sector. Still, progress is possible. In Africa, for example, personal income tax revenue has roughly doubled as a share of GDP since 2000. Strengthening these taxes is important not only for revenue but also for progressivity, as higher-income individuals pay a larger share of their income in taxes.

Finally, property taxes on land and real estate remain significantly underused in most developing economies. These taxes are difficult to avoid and can be particularly effective in raising revenue for local governments. However, they often face political resistance and administrative challenges, such as outdated property registries.

Tax design

Good tax design aims to raise revenue while minimizing economic distortions and inequities. A central principle is neutrality: Taxes should interfere as little as possible with economic decisions about work, saving, investment, and consumption. In practice, this usually means a broad tax base combined with moderate rates.

Yet most tax systems deviate from this ideal. Governments frequently introduce exemptions, deductions, reduced rates, and special regimes—collectively known as *tax expenditures*.

While some of these provisions serve legitimate policy goals, their cumulative cost is often large, amounting to 3 to 4 percent of GDP in many countries (about a quarter of tax collections).

Not all tax expenditures are harmful. Simplified tax regimes for small businesses can reduce compliance costs; targeted tax relief for low-skilled workers may help boost employment. Problems arise when tax preferences proliferate without careful evaluation. Poorly designed exemptions can create distortions, undermine fairness, and add complexity—making it harder for governments to administer taxes and easier for taxpayers to avoid them.

Regular review and transparency are essential. Governments must ask whether each tax preference achieves its intended goal and whether it is the most effective tool available.

From policy to practice

Even the best tax policy fails without effective implementation. Weak administration can erode revenues, undermine fairness, harm investment, and damage trust in the system.

Many developing economies struggle with limited administrative capacity and large informal sectors, where businesses and workers operate outside the tax net. Noncompliance is a major challenge, with lost VAT revenue alone costing developing economies about 3 percent of GDP on average.

Yet expanding the taxpayer registry indiscriminately is often ineffective, as many informal operators earn too little to owe tax. More successful strategies include withholding taxes collected at the source by large intermediaries, such as employers or banks; risk-based audits that focus enforcement on higher-risk taxpayers; and digitalization, including electronic filing and payment, real-time invoicing, and data analytics. Advances in digital technology, including the use of artificial intelligence, offer powerful tools to improve compliance and reduce administrative costs.

Clear and simple tax laws also matter. Complexity and frequent legal changes create uncertainty and open the door to corruption. Many countries

still need to strengthen the basics of tax administration: investing in skilled staff, modern organizational structures, and strong governance.

Experience across countries offers three broad lessons.

First, think in systems. The tax level, mix, design, and administration are closely linked. Isolated reforms—such as introducing a new tax without strengthening administration—rarely deliver lasting results.

Second, be patient. Building tax capacity takes time. Quick gains are possible through measures like withholding or inflation indexation, but sustainable improvements often require years of consistent effort. Countries that have succeeded have done so gradually, maintaining reform momentum across political cycles. Progress can easily be reversed by policy instability or crises.

Third, international cooperation helps—but it’s not enough. Information exchange, tax treaties, and global agreements on corporate taxation are valuable, especially in an increasingly integrated world. But they cannot substitute for strong domestic institutions. Overly high expectations of international solutions risk diverting attention from essential domestic reforms.

Politics and trust

At its core, domestic revenue mobilization is about trust. When people see taxes as arbitrary or corrupt, compliance suffers. When they see them as a contribution to shared prosperity—financing schools, hospitals, infrastructure, and social protection—support grows. Strengthening this trust is perhaps the hardest part of domestic revenue mobilization, but also the most important.

Transparency, accountability, and clear communication are essential. In the end, paying taxes should not feel like losing private wealth, but like investing in a shared future. Only then can domestic revenue mobilization fulfill its promise as a foundation for sustainable development. **F&D**

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