Advances in Politics and Economics
ISSN 2576-1382 (Print) ISSN 2576-1390 (Online)
Vol. 5, No. 3, 2022
www.scholink.org/ojs/index.php/ape

Original Paper

Democracy's Invisible Savior: Why Citizens Should Welcome Taxes with Open Arms

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Received: May 28, 2022 Accepted: June 8, 2022 Online Published: June 20, 2022

doi:10.22158/ape.v5n3p31 URL: http://dx.doi.org/10.22158/ape.v5n3p31

Abstract

This article aims to understand the transformative power that the fiscal requirement to impose taxation has on democratization. An exploration into the fiscal development of early modern Europe alongside modern empirical examples, demonstrates the value of taxation as a solution to leaderships that don't represent their people. It's reasoned that the confluence of taxation and democracy can be attributed to two distinct mechanisms. One, that the government is more willing to compromise to the peoples' demands, and two, that the people are more willing to demand this compromise. The latter is of particular significance in suggesting the role that behavioral phenomena play in inflaming democratic engagement. Critically, the behavioral effects of taxation should take more of a leading role in policies that pursue democratization whilst aid, more of a support role.

Keywords

democracy, taxation, citizen participation, loss aversion, representative governance, tax bargaining

1. Introduction

The freedom that the leaders of petrostates—most notably those of the gulf economies—have been granted by their opulence of resource wealth, has been eyed with envy by other nations. The chateaus of Saudi Arabia, or the gilded architecture of Qatar, are of particular salience. Increasingly however, this envy appears to have been merely in the eye of the beholder. The state revenue of these economies has been entirely fueled—quite literally—by high oil prices. Amongst the many disturbances of 2020, was the colossal crash in the price of oil. Price wars in March saw the sharpest decline since 1991 (Stevens, 2020). Whilst oil has since rallied back to high prices, the Russian invasion of Ukraine has awoken the world to the myriad of geopolitical risks that surround a dependence on fossil fuels. Volatility in oil markets and the resounding calls for renewable energy indicate that it won't be a reliable source of revenue for oil exporting nations for long—suggesting that oil may be unsustainable in more ways than one.

The 2020 oil price collapse, whilst no doubt the source of headache for many a fund manager, also exposed how vulnerable oil-rich economies' balance sheets really are (Miller, 2020). In 2020, the Algerian government required oil priced above US$100 a barrel to balance its books (The Economist, 2020). The UAE required US$70 per barrel (Financial Times, 2020). For Saudi Arabia, US$83 (Financial Times, 2020). Yet in 2020, the price sunk beneath US$30 per barrel (The Business Times, 2020). Amassing further debt to offset such oil losses didn't offer much hope to many of these nations—Oman was projected to owe 89-percent of its GDP to creditors (The Economist, 2020). An oil market crisis couldn't have come knocking at a worse time. The onslaught of the Covid-19 pandemic didn't just damage demand for oil, it froze tourism—a revenue alternative for Gulf nations—in its tracks, to deliver a simultaneous blow. All of which, raises a larger, far more consequential question: when a government has nowhere left to turn to for money but to its own people, what will happen?

2. A Historical Account

Leadership that can no longer sustain itself by way of externally sourced revenue, unable to buy loyalty or pay-off competition, faces a transformative dilemma. Such a state will be forced to pivot elsewhere for financing—*taxation*. The historical record provides a curious account of this process. The Holy Roman Empire, a collection of sovereignties in Western and Central Europe over the Middle Ages to the 19th century, displays iterations of fiscal development. Unlike death, there was no certainty in taxes during early modern Europe. Initially, court fees, commodity sales and other monopolies were the source of sovereign revenue. However, as the costs of warfare with neighboring territories increased, survival depended on finding additional revenue. Rulers began to solicit this revenue by levying tax on their subjects (Bates & Lien, 1985, p. 54). This created a dilemma for the state: if citizens were to be expected to contribute their income to the monarch, then the citizenry had not only been supplied a cause to expect better treatment, but they'd also been given a means to negotiate it too.

The capability of private agents to resist taxes, meant that those early modern European states who choose to impose said taxes, had to engage in *tax bargaining*. If citizens were to voluntarily participate in this new revenue model the state had to earn their acquiescence by ceding them political voice. This led to the expanded provision of public goods and the creation of institutions including financial councils (Cantoni et al., 2019, p. 8). Consequently, the government inevitably had to transform into one that was more representative of the people. As a result, by the early 17th century England had established a more or less independent court and Parliament (Prichard, 2015, p. 51). England was not the only nation to do so—notably, France and the Netherlands amongst others (Prichard, 2015, p.51; *Netherlands Institute for Multiparty Democracy*, 2008, p. 9).

2.1 Give Me Tea and Give Me Freedom

Of all the historical examples, a particularly theatrical one comes from the role that Britain's relentless taxes played in inciting the American Revolution of the 17th century. British Parliament's tea tax infuriated American colonists so much so, as to prompt patriots dressed as Mohawk Indians to forcefully hurl an entire ship's supply of tea overboard—the infamous Boston Tea Party of 1773 (Prichard, 2015, p. 53). This was a clear example of collective action by the people to demand greater representation. Importantly, whilst tax bargaining need not always require citizens to go so far as to flood a harbor with ninety-thousand pounds of tea leaves, minimal citizen engagement can still prompt democratic change. Even economist Joseph Schumpeter in his 1918 Crisis of the Tax State, acknowledged the requirement of financing the state as empirically being the driving catalyst of social and political change (Schimdt, 2003, p. 342). In plain English: the transition from the feudal system to the capitalist free economy was reliant on the tax state.

The notion that the introduction of tax will spark democratization is an alluring idea. However, it isn't so simple. Firstly, negotiating power is never distributed evenly amongst a population. In the Holy Roman Empire, aristocratic taxpayers with significant wealth—the most important taxpayers—had the resources and profile to demand compromise. Comparatively, the peasants did not. This reality was recognized by Montesquieu, who noted that monarchs needed to exercise restraint where mobile assets were abundant (Bates & Lien, 1985, p. 60). Indeed, agrarian states (home to poorer citizens) were more likely to use coercion to collect taxes from their people in comparison to the leaders of capital-intensive ones (Cantoni et al., 2019, p. 50). Secondly, some sovereigns, uninterested in entertaining citizen demands, never bothered to engage in a negotiating process in the first place. Why did taxation spur democracy in some territories in early modern Europe but not others? Put simply, whether the necessity of taxation leads to democracy is sensitive to many factors. Whilst taxation does confer power to the people, it does so in unique ways. This is particularly evident in today's world.

3. A Theoretical Account

3.1 No Taxation without Representation

A theoretical exploration into the transformative effects of introducing tax is first taken. This process—tax encouraging representative governance—condenses into two distinct mechanisms. First, the government will be more willing to compromise to the demands of its people, and second, the people will be more willing to demand better governance. The former arises from the simple fact that by requiring the population to supply the revenue, the government has empowered the people with a choice (Paler, 2013: 709). Taxpayers can choose to undermine the government's fiscal strength by refusing to oblige their tax requirements. The government is therefore incentivized to placate taxpayers into quasi-voluntary compliance through compromise. Citizens might demand the expanded provision of public goods and services—perhaps improved schools or infrastructure—or even an end to corruption. Tax bargaining, that is, a citizen's ability to leverage their choice to extract government concessions, effectively transforms their power vis-à-vis the government. Furthermore, should citizens demand transparency, the subsequent publicization of budgets and establishment of independent tribunals will improve tax infrastructure itself—a cycle of improvement and mutual behavior adjustment.

However, a government's incentive to compromise is only half of the explanation. In the absence of taxation, what has stopped citizens from using elections or similar leverage to demand accountable governance? This puzzle can be explained by the second mechanism. Put simply, the people are willing to demand better governance. Citizens who are told to forfeit their income are very quickly intolerant of an unresponsive and corrupt government (Paler, 2013, p. 723). Several psychological theories underpin this phenomenon. Behavioral economists Daniel Kahneman and Amos Tversky identified that people display a consistent pattern in their choice preferences. Specifically, that avoiding a loss is preferred to receiving an equivalent gain, labelling this *loss aversion* (Kahneman & Tversky, 1979, p. 279); (Tversky & Kahneman, 1991, p. 10). A government that begins collecting from citizens own income, has shifted its citizens into the psychological "loss realm". Whereas, when a government simply siphons away foreign aid, citizens only lose a potential "gain". If a citizen's loss in utility, as roused by the imposed tax, is accompanied by corrupt governance, their tolerance for inadequate government will be uniquely eroded.

An extension to loss aversion, the *endowment effect*, describes that people appraise a higher value to those objects which they perceive ownership of (Kahneman et al., 1991, p. 194). In 1991, Kahneman was joined by Richard Thaler and Jack Knetsch, to study this phenomenon. In this study, some participants were gifted a mug to prompt their sense of ownership over the good, whilst other participants were not. Participants were then able to sell or trade the mug. The results showed that those participants who felt "ownership" would only agree to sell a mug at an average of twice the amount that they'd be willing to pay to purchase the same mug had they not felt ownership (Kahneman et al., 1991, p. 196). Applying these findings, requiring citizens to contribute a share of their income fosters their perception of ownership over national revenue. After the introduction of taxes, the interaction of loss aversion and the endowment effect positively operate to drive citizen engagement. Both the personal loss of a citizen's income and their newfound sense of entitlement to state income, has provided citizens with a significantly more powerful motivator to punish and hold their government accountable. Comparatively, a leader's abuse of externally sourced revenue simply won't spark outrage and collective action the way misuse of tax revenue will.

It is emphasized—and cannot be understated—that the revenue raised itself is irrelevant to the primary role that taxation plays in democratization. Yet, when tax is proposed as a development solution revenue is too often the focus and capacity too often the language (Bachas, Kondylis, & Loeser, 2021; Pomeranz & Vila-Belda, 2019). If raising more revenue was the solution, resource rents, foreign aid or other externally sourced revenue would have furthered democracy already. Foreign income requires little—if any—interaction with local citizens, reducing the government's reliance on local support to almost nil. In effect, financing a budget wholly externally is counterproductive to good governance. Thus, what matters is the means in which the revenue is raised not the revenue itself. It's unlikely that the fiery sentiment behind the famous American Revolutionary slogan, "*no taxation without representation*", would have emerged without the relentless taxation by the British. The greatest power of taxation: it reaps participation dividends.

3.2 A Solution or a Siren Call?

Despite the compelling siren call of the theoretical account of tax and democracy, it's likely of no surprise that in reality a happy outcome is far from guaranteed. In predicting whether tax will promote democracy, several factors must be considered. A government with an alternative means to externally source funds won't risk the political costs of imposing taxes. Therefore, the level of fiscal pressure facing a government is the first factor (Prichard, 2015, p. 70). Secondly, taxpayer capacity to bargain, as influenced by the extent of political openness in an economy, is important (Prichard, 2015, p. 73). A state with a repressive government that has few independent civil or business organizations may not see democracy gains from the imposition of tax alone. Third, is the availability and strength of institutions, including parliamentary processes, which can facilitate bargaining (Prichard, 2015, p. 75). Finally, is the political salience of introduced taxation (Prichard, 2015, p. 76). Citizens can't protest taxes that they aren't aware of, and not all taxes are designed to be visible—an insidious yet often common strategy for governments to have their cake and eat it too.

These factors combine to influence citizen's expectations of, and trust in, their government—both of which are very important. Citizen's demands are tethered to their own perceptions of the role of government, meaning they are quite literally limited by their imagination. And when there is no trust, citizens may choose to simply evade taxes altogether. However, despite these potential pitfalls the imposition of taxation *has* been shown to positively affect democracy in some environments, suggesting it indeed is a possible solution.

4. An Empirical Account

The greatest argument for the specific use of taxes to encourage democracy are empirical examples. The Democratic Republic of Congo (DRC), a kleptocracy of sorts, collects little tax and has neither much citizen participation nor formal channels for such (Weigel, 2020, p. 1857). Kananga, a city in the DRC, suffered a loss in diamond revenue after decouplagé of local government in 2015 (Weigel, 2020; 1858). A narrative that was reminiscent of many petrostates in 2020, Kananga's government found itself looking to other sources of income. A field experiment in Kananga published in 2020 provides evidence that introducing taxation can indeed prompt citizens to demand representative governance (Weigel, 2020, p. 1853). This study measured the impact of property tax collection on citizens who had never previously been registered to pay formal taxes. This randomized rollout was the first citywide tax campaign. Prior to its introduction, only 39-percent of Congolese citizens had even heard of the provincial tax ministry and fewer than eight-percent made tax payments (Weigel, 2020, p. 1857).

Post-campaign, the study found that political participation in the form of attendance at town hall meetings and submission of evaluation forms had significantly increased (Weigel, 2020, p. 1872). These citizens were even willing to incur costs—largely travel and foregone work—to do so. The demands made by these citizens included more inclusive government, public goods such as improved infrastructure and greater transparency. One participant said: “Erosion threatens our neighborhoods, and the government does nothing…so why should we pay?” (Weigel, 2020, p. 1855). Whilst another wrote: “inform us how this money will be spent…[and] not wasted on other things” (Weigel, 2020, p. 1896). The mere fact that citizens attended forums at all indicates their attempt to achieve policy concessions. Some of these citizens agreed to be registered as a formal taxpayer but did not pay the tax in the end. This in of itself demonstrates the process of tax bargaining in action.

Perhaps of most interest was the finding that study participants’ expectations of their government were influenced. Citizens positively updated their expectations of reciprocity and an improved administrative ability of the Kananga tax ministry (Weigel, 2020, p. 1853). Such an update to norms and expectations plays a vital role in civic engagement and a reformed, more resilient, social contract. It appears that in this case the mere fact that the ministry tried to register taxpayers—whether they paid or not—signaled a capacity improvement. It’s important for long-term progress that citizens have faith in the capability of their public institutions. Signals of state competence in Kananga allowed citizens to demand better governance once they knew the government was capable of it. Indeed, those individuals who did comply with taxes were more likely to express positive attitudes towards leadership. Overall, incidents of bribery were reported at very low and property tax compliance increased—signaling that tax bargaining can have benefits for both the people and the government. The campaign, by increasing an individual’s sense of ownership over public revenue, resulted in a significant broadening of the tax base and a sizeable expansion in the formal presence of the state in Kananga (Weigel, 2020, p. 1852).

Uganda has had a similar political environment of corruption and ineptitude. In 2012, an investigation found that aid money worth US$20 million effectively disappeared from public accounts (Martin, 2014, p. 6). Whilst the scandal was covered by Ugandan media, and despite the fact that Uganda relied on such aid to fund many public goods, surprisingly citizen outrage was almost non-apparent. There was little political consequence for the incumbent party. However, when local government in Lira, a Ugandan city, stopped collecting trash from a local market, the citizen outrage was in stark contrast to that of the aid scandal (Martin, 2014). To be a vendor at this market required a fee payment—a tax of sorts—used to fund local government. In return for this fee, the government agreed to collect the market trash (It’s evident why the participants were upset when the trash stopped being collected). In protest to the overabundance of trash the market vendors left the garbage in front of the City Hall and threatened to similarly dump it at council member’s houses (Martin, 2014, p. 5). In short, collection of the trash was swiftly resumed.

An example of the undeniable potential of tax in paving broader democratic reform comes from Ghana. In the 1990s Ghana faced increased fiscal deficits and consequently in 1995 the government introduced a Value-Added Tax (VAT) on goods and services to combat its losses (Prichard, 2015, p. 218). The government was met by nationwide protests which saw tens of thousands take to the streets. Whilst the introduction of a sales tax sparked the initial protests, they quickly grew into demands for broader policy transformation (Prichard, 2015). The movement, in unifying previously disparate opposition to the repressive government, developed into demands for dramatic expansions in accountability and representativeness. The VAT was repealed and not introduced again till 1998 after it had been reformed (Prichard, 2015). In successive governments when further increases in VAT were attempted, the government had to first agree—at the behest of the public—to designate the new revenue to specific public programs. This led to the creation of the National Health Insurance Scheme and Ghana Education Trust Fund (Prichard, 2015). The overall result was significant progress towards transforming Ghana into a more inclusive and open political environment.

Comparatively, prior introductions of taxation in Kenya did not lead to sustained civic engagement nor immediate government concessions. When a VAT was introduced in the early 1990s, opposition to this tax was relatively absent (Prichard, 2015, p. 122). This absence has been attributed to Kenya's repressive government which would have limited taxpayer scope to bargain or organize (Prichard, 2015). Such passivity supports the reservation that levying tax is not always guaranteed to result in tax bargaining outcomes. However, even when direct bargaining isn't available, taxpayers can still slowly undermine an administration through evasion—simply refusing the tax altogether.

Despite the absence of instantaneous results in Kenya, it's likely that longer term change did still occur. Tax resistance in Kenya during the nineties incrementally weakened the government's fiscal stability and likely aided the eventual political transition in 2002 (Prichard, 2015, p. 3). The incoming government—likely aware of the detrimental impact of tax resistance on the previous government—explicitly sought to reform tax administration and improve local accountability (Prichard, 2015). Whilst in some contexts such as Ghana the effects of taxation on democracy do seem to appear overnight, this is often not the case. Yet, incremental changes not observable for years into the future can still come to fruition, suggesting tax had a positive impact after all—changing norms and expectations may take time. Often, it may only be later governments that recognize the need to reform.

Ethiopia has also demonstrated similar challenges to the ease with which tax can solve all problems. Previously, Ethiopian governments have attempted to raise taxes, however, on each occasion there has been a noticeable lack of associated tax bargaining (Prichard, 2015, p. 190). This may likely have been the result of a weak private sector and repressive political characteristics (Prichard, 2015, p. 191). Low public expectations of government responsibility may have also played a role. However, once again more subdued resistance to tax likely contributed to incrementally improving democracy in Ethiopia. (It's suggested that fiscal crisis was pivotal in ending the repressive Derg leadership in the late eighties (Prichard, 2015, p. 169). Before democracy can prevail, civil society organizations and other independent groups that can facilitate bargaining may need time to develop. Indeed, after the expansion of business taxes in Ethiopia business associations that engaged with the government were eventually increasingly established (Prichard, 2015, p. 3). Despite the challenges, tax—if salient—will ignite outrage, and that is what's important.

Finally, an obvious though not yet discussed argument for the use of taxation to further democracy is the alignment of objectives targeting GDP growth. A government that earns its revenue through taxation is only as rich as its economies' GDP permits and will quickly find incentives to boost economic growth. Rational governments should therefore invest in economic growth policies; optimistically, this could include encouraging the employment of women and minority groups. In the case of nations such as Saudi Arabia, this could have transformative and long-lasting effects for female empowerment.

5. Future Implications

The finding that introducing tax has a behavioral impact and consequent democratic effect has important implications for international policy. First and foremost, the centrality of taxation to not just economic, but political development, needs to be more critically considered. There should be a greater shift away from the perception of tax as a solution to simply generate revenue towards a solution that encourages civic engagement in its own right. Much of the current focus of international tax development, in particular that of the OECD in re-allocating taxing rights more equitably away from havens (OECD, 2021), whilst important, synonymizes tax with revenue. Whilst increasing federal revenue is useful in that it can fund public services, without a functioning system of governance in place first this revenue isn't guaranteed to be distributed, let alone efficiently distributed, to the citizens. There is considerable scope for a greater focus of international development to include the behavioral applications of tax in the pursuit of democratic change.

However, where tax *is* pursued as a democratic solution, certain characteristics must be included in any reform attempt if it is to be transformative. Firstly, implemented taxes must be salient to taxpayers. This means that taxpayers must both feel the effect and be well educated in exactly what the tax is and its operation. In some regions, property or land taxes are the most salient and effective tax to implement, in other regions, this mightn't be the case (Weigel, 2020, p. 1898). In designing new tax, administrators should consider how to explicitly link each tax to specific public expenditure or governance oversight programs to gain public support. Equally, the bargaining efforts of citizens should also be salient where possible. People tend to follow their peers—one needn't look far to know this. When citizens believe their fellow citizens are similarly engaged in tax bargaining, the effects are further compounded (Del Carpio, 2014, p. 31).

Secondly, tax infrastructure should be designed with horizontal equity. Taxpayers must believe they're being treated similarly to their peers—it does no good if civilians are simply encouraged to turn on one another. Perhaps not immediately intuitive, but this is most important amongst aristocratic taxpayers who have the power to bargain on behalf of the wider population. If faced with a uniform tax burden, elites—who have the greatest capacity to do so—will be more incentivized to make collective demands through their united agenda (Bates & Lien, 1985, p. 53). The allowance of discretionary tax exemptions for wealthy parties has no effect other than to be self-serving. Furthermore, tax bargaining and collective action should be actively encouraged. This may include supporting local institutional pathways for bargaining. It will also require using outreach to taxpayers to provide sufficient information to allow their participation. Though not exhaustive, these features are a good start.

The elephant in the room—or rather, this paper—concerns the role of foreign aid. Dramatic tax revenue declines in Ethiopia have been correlated with increased foreign aid assistance—and this example does not exist in isolation (Prichard, 2015, p. 260). If international aid inflows can directly undermine civilian propensity towards action, should foreign aid be ceased altogether? Whilst this might be tempting from a budgetary perspective, severing all external aid flows is unlikely to be the solution. Simply removing inflows of aid won't guarantee that tax collection will be used as a substitute in the recipient country. Rather, aid should be strategically directed at providing technical assistance to these governments. Too often aid benefactors focus on simply increasing revenue or correcting market distortions rather than on the broader picture of developing an environment that is supportive of tax bargaining (Prichard, 2015, p. 261). Including local tax contributions in aid packages may help to increase beneficiaries' feelings of ownership over the total revenue—and hence their call to action. What is most important, is that aid is not supplied to developing regions with the intention to merely replace tax revenue; democratic gains should be able to outlast intervention.

In encouraging developing governments to introduce tax there are a few minefields to navigate. Namely, that some governments in anticipation of the resistance they'll meet actively choose to forego tax revenue, preferring to avoid citizen's demands altogether. It is telling that in some countries, including Uganda and Ethiopia, taxes have been reduced prior to elections (Martin, 2014, p. 4). Alternatively, such leaders may also choose to implement more opaque taxes (Weigel, 2020, p. 1898). For example, the introduction of consumption or other indirect duties—where the cost isn't immediately clear—mightn't spark enough citizen action to spur collective movement. Although, an indirect tax in of itself isn't necessarily always invisible—after all, the mass protests that prompted broad change in Ghana were sparked by the introduction of a sales tax (Prichard, 2015, p. 91). Whilst the introduction of tax holds transformative potential, it must be acknowledged that not every leadership will be interested in this transformation—even if it would deliver them more revenue. Unfortunately, the contexts in which tax bargaining may be most necessary, are also those in which it is likely most difficult.

Finally, when designing tax infrastructure to develop an economy, the timeline of reigning power should be considered. When frequent elections with alternating leadership are the norm, longer-term incentives are introduced to governments (Prichard, 2015, p. 76). If a government has confidence that, should they lose power, there is a reasonable chance they'll be re-elected in the future, they'll be more incentivized to produce longer-term benefits. Comparatively, leadership with shorter timelines will be hesitant to make fiscal changes, the benefits of which should they be forced out, will go to their successors.

6. Conclusion

6.1 We the People

Transitioning an autocracy to democratic leadership ultimately requires that the people demand it. However, the challenge lies in convincing them to do so—taxation is one such solution. The behavioral effects of levying taxes are an increasingly robust empirical phenomenon that should be more broadly applied to international development efforts. Critically, there needs to be a repositioning of tax amongst international development communities as more than simply a means to an end to provide social welfare, but as a central tool of democratization.

As the world continues to marvel at the increasing flippancy of oil price volatility, it'll also witness how the petrostates cope with the aftermath. Some have the coffers to weather price storms into the near future, yet others have balance sheets that already aren't adding up, even despite the current historically high prices. When oil revenues once again decline such states inevitably will begin to ask their citizens to make sacrifices, governments may have to meet them halfway. Perhaps taxpayers in Saudi Arabia would be more enthusiastic to contribute tax if the Crown Prince sold his US$550 million yacht first (The Economist, 2020). Will these nations seize this opportunity for democratic reform or will governments coercively take taxes from the people with little regard for their interests? Whether the latter strategy will hold in the long run is unlikely. However, what *is* clear is that 2020's collapse in the price of oil didn't just present the opportunity to leave the remaining hydrocarbons in the ground, but so too the days of governance that doesn't represent its people. And just like the threat of climate change, the clock is also ticking on unsustainable governance.

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