The Fiscal Social Contract – Looking Beyond the Theory

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Introduction

Conceptually, the social contract theory is fairly simple: an arrangement in which individual rights are yielded for the sake of the collective interest, with an expectation that the central governing authority will deliver protection and/or other public goods to society in return. Social contract theory is supposedly an expression of the consciousness of a people, their underlying motivation for organising themselves into society, and from which governments, particularly in democratic settings, derive legitimacy.

Taxation has always been a prime example of the social contract at work, as it brings to life with irrefutable clarity, an awareness of the monetary transaction between a state and its citizens. The periodic filing of tax returns lends a personal touch to each member of society, bringing the reality of the social contract even closer home. The social contract theory, therefore, sits at the heart of the tax discussion, being the perceived basis for our political

organisation and the defining framework of our fiscal relationship with government. In a social contractarian sense, taxation would be viewed as a contribution of personal assets to the commonwealth in the expectation of delivery of public goods by the government to the collective. Hence, the fiscal social contract.

Yet, the contract appears to be fraying, and not just at the edges. As will be seen in this article, in the experience of many societies, the social contract is somewhat elusive in practice, especially when discussed against the backdrop of fiscal accountability, or the lack thereof. With public goods largely in shortage in developing and even in some developed societies, the fiscal social contract sometimes appears one-sided, with governments scarcely holding up their end of the bargain. It inevitably begs the question: is this a contract after all, and can the social contractarian theory continue to hold as a justification for taxation?

Undeniably, the social contract theory is not without its challenges. Questions arise as to who exactly its parties are. The Lockean variant of the theory includes government as a party to the contract, but Thomas Hobbes does not. This has implications for enforcement. Many variations of the theory exist, yielding definitions that are abundantly imprecise. At what point could the contract be said to have come into force? Is there a place for the social contract in pseudo or non-functional democracies? Notwithstanding that the social contract theory espoused by Jean Jacques Rousseau stressed the three main principles of liberty, common needs and reciprocity, to what extent, if any, is the contract enforceable? Of what use is the social contract without bindingness or a clear-cut mechanism for enforcement?

A discussion of the fiscal social contract is, therefore, of necessity, one of social justice. It is a discussion of duty and of corresponding rights to public goods that must follow if legitimacy will be properly ascribed to the arrangement. It must be a conversation that goes beyond idealistic narratives to a practical investigation into how taxation can be applied as a tool for social good within a given society.

This paper examines the intra-national dimensions of the fiscal social contract,

with a focus on the experience in developing societies. Helpfully, some more advanced societies have demonstrated a semblance of a positive relationship between taxation and the social contract, beyond the realm of mere potential or aspiration. Drawing guidance from such advanced societies, this paper also discusses what social, legal, and political pillars must be in place in society to support the framework of taxation from a social contractarian perspective.

Lifting the Conceptual Veil

A discussion on taxation and the social contract is not one to commonly be had at international tax fora, certainly not at this time when the attention of the international tax community is focused on issues that are more aligned with 21st century realities, such as the taxation of highly digitalised businesses. Yet, it would be simplistic, at the least, to assume that foundational issues touching on the relationship between taxation and the social contract have been robustly or sufficiently addressed globally. This is not the case in many societies, particularly in many developing countries where there remains a wide gap between the promise of taxation and its actual impact on the collective socio-economic interest. In such societies, beneath the surface of tax law and its numerous intricacies, the conversation on improving taxation remains hollow, lacking in what may be considered its most essential element – a *quid pro quo.*

The Fiscal Social Contract in Practice – Contrasting Experiences

Indeed, the experience of the fiscal social contract is very different from society to society. Examples from some developing countries tell a story of an immobilised social contract and by extension, an impaired framework for effective taxation. In the Afrobarometer Working Paper 143, which conducted studies in Kenya, Uganda, Tanzania and South Africa, we find a negative correlation between tax compliance and payment for public goods to non-state actors. It was found that where donors and non-governmental organisations were responsible for providing educational, health and security services to citizens, a weak tax compliance attitude was likely. Citizens' payment to non-state actors for public services counteracted the fiscal exchange, which is the fulcrum of the fiscal social contract. A study conducted in Indonesia showed that only about 22% of the working population filed a tax return, with poor public infrastructure and corruption cited as reasons for weak compliance. A

similar study conducted in Nigeria attributed tax compliance apathy to harsh socio-economic living conditions, weak citizen engagement by government, and dysfunctional audit systems.

Yet, in the United Kingdom, a June 2019 release by the UK government reported that from 2017 to 2018, the UK tax authority secured 94.4% of all tax due. Similarly, a 2016 report published by the Government of Canada showed Canada enjoying a high level of tax compliance, '*with 93 percent of individuals filing their tax returns and paying their taxes on time*'. A 2018-2019 survey conducted in the UK on public attitudes towards taxation and public spending found that people were willing to accommodate increased tax rates for more extensive public services by government, a result which evinces a healthy degree of confidence that there exists a direct correlation between payment of their taxes and public service delivery. This paints a picture that shares a closer resemblance to the promise of the social contract, than the experience in other societies discussed earlier, buttressing the point that the experience of the fiscal social contract is very much context specific, depending on the society involved.

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Less of Tax, More of Social, Legal and Political Considerations

Based on the sampled information, in discussing the fiscal contract, over and above discussions centred on improving the tax system *strictu sensu,* considerable attention needs to be paid to the socio-legal and political framework which sets the stage for taxation to be implemented. Social, legal and economic factors such as strong institutions for citizen engagement and civic education, opportunity to seek judicial redress for government failure in public service delivery, unhindered freedom of speech, as well as decentralised political structures for ease of access to elected officials are some of the factors which prove critical in bolstering the fiscal relationship between citizen and

state.

Grassroots Citizen Engagement and Decentralisation For instance, Lagos State in Nigeria has often proved an outlier from the general norm of tax compliance apathy that is pervasive in Nigeria. A 2018 research conducted by the International Centre for Tax and Development into the Lagos State Land Use Charge recorded that not only was there an enormous increase in tax collection, the land use charge 'helped to support personal income taxation and to solidify the fiscal contract between state and society more broadly'. Considering the widespread tax compliance apathy in Nigeria, such results in Lagos State are noteworthy. The following excerpt from the research provides insight:

> *'A further significant element of the general tax reform story in Lagos relates to how public support for taxation was mobilised over just a few years, indicating the evolution of a nascent social contract (Cheeseman and De Gramont: 471; see also Bodea and Lebas 2016). Through highly visible infrastructure projects, including the introduction of Bus Rapid Transit (BRT) and improvements in waste collection, as well as increased attention to security, the legitimacy of State-level taxation has been established to a significant degree. In the recent analysis provided by Cheeseman and de Gramont (2017), a crucial motivating factor for this overhaul of governance and taxation was the determination of Lagos' leaders to realise their 'mega-city ambitions', in part to attract increased investment. Linked to this was the desire to prove what the South-West of Nigeria could achieve, in the context of longstanding neglect by the Federal government and a State government controlled by the opposition'.*

[Emphasis mine]

The above exemplifies a departure by the Lagos state government from reliance on centralised funding from the federal government to a more decentralised approach to taxation, in keeping with Nigeria's federal system. Furthermore, the research reports that the key role played by the state governor in ensuring that the implementation of the entire process was governed by the mantra of '3 Fs': follow up, follow through and feedback. It is

recorded that the state governor '*published his own mobile phone number in the newspapers, urging people to provide feedback as a way of 'crowdsourcing' data. He would reportedly systematically forward all messages he received to relevant staff in LRC, demanding timelines and feedback. The CEO of LRC had his phone number published on tax demand notices to ensure that feedback would go directly to the top'.* Rightly identifying citizen engagement at the grassroots was key to unlocking popular acceptance and legitimacy of the tax rules.

Legal Enforcement

Critical to the realisation of the fiscal social contract is its enforcement. An example from the international tax arena is apposite. In a paper by Professor Alisson Christians, 'Sovereignty, Taxation and Social Contract', she discussed the notion of an international social contract arising through interactions in transnational settings. In that paper, she argues that the interdependence among countries in the prevention of harmful tax competition was gradually framing an implicit global social contract in which countries, consciously or otherwise, yield some of their tax sovereignty to the international tax community, with the Organisation for Economic Cooperation and Development (OECD), as overseer. Today, the OECD's work in propagating this global social order in taxation has been largely successful, with numerous multilateral instruments signed, as well as sanctions and blacklists measures taken against erring nations at European Union level. These measures have seen countries adjust their domestic rules to align with evolving global tax norms, demonstrating the necessity of an enforcement mechanism in the social contract.

It follows reason that in domestic settings which are possibly more prone to abuse, the fiscal social contract must be backed by legal enforcement mechanisms in those societies. For instance, it is dismal that the Fundamental Objectives and Directive Principles of State Policy as enshrined in Chapter 2 of the Nigerian Constitution 1999 (as amended) have been interpreted by Nigerian courts as unenforceable. This chapter of the Nigerian constitution sets out the core rights of Nigerians to a meaningful socio-economic life in line with the reasonable expectations of the fiscal social contract. Ironically, Nigerian courts

insist that these be interpreted as an aspirational manifesto, lacking justiciability in a Nigerian court of law. It is here proposed that in upholding its end of the fiscal social bargain, the Nigerian government through the instrumentality of its judicial system ought to interpret these rights according to the principle of indivisibility of human rights, without distinction as to political, economic or social rights.

Economic Diversification Furthermore, research by the UK Institute of Development Studies also identified there is a direct correlation between psychological ownership of public funds and governance expectations. A strong sense of psychological ownership of public funds would hardly arise in a rent-based economy that relies principally on revenues from natural resources for sustenance. Tax rates would typically be relatively low in such jurisdictions with the ripple effect of a weakened sense of psychological ownership of public funds by citizens. Lowered governance expectations would follow closely. A study from Colombia shows that less reliance on natural resources such as royalties from oil extraction to fund government spending results in more accountable and responsive governance with less corruption. Benefits of the fiscal contract would more likely be reaped in such a setting.

Conclusion

These abovementioned are issues that feed into a wider discussion on the economic, legal and socio-political framework, and not just a narrow focus on tax law or policy. Tax policymakers, particularly in developing countries, must, therefore, take cognisance of the broader issues that interact with the fiscal social contract, all of which must work together like well-oiled parts of the engine of governance.

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