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Death and taxes: Political violence shapes local fiscal institutions and state building

Rafael Ch, Jacob Shapiro, Abbey Steele, Juan F. Vargas 29 January 2019

It is widely accepted that war between states can lead to increased fiscal capacity. Yet, there is no similarly clear, historically consistent accounting of how civil wars have affected state capacity and tax revenues. Using recent evidence from Colombia, this column shows that municipalities affected by internal conflict have tax institutions consistent with the preferences of the parties that have managed to inflict more violence in the past. Internal armed conflict can help interest groups capture municipal institutions for their own private benefit, impeding state-building.

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The idea that war between states can lead to increased fiscal capacity is a foundational one in the field of political economy. Tilly (1992) famously argued that the national state in early modern Europe emerged in response to the fiscal demands created by expansionary external wars. Tilly memorably wrote “... war made the state, and the state made war”. More recently, Centeno (2003) and Vu (2010) provide historical evidence consistent with this perspective in Latin America and Asia, respectively, and Scheve and Stasavage (2012) show that inheritance taxes were systematically higher during periods of mass mobilisation for conflict from 1816 to 2000.

Interestingly, there is no similarly clear, historically consistent accounting of how civil wars have affected state capacity and tax revenues. There are a range of reasons to expect that internal armed conflicts and negatively impact state capacity—e.g. societies with significant armed groups will invest less in fiscal capacity. At the cross-country level, Besley and Ghatak (2014) show that greater conflict is associated with lower tax revenues. And in Colombia, Besley and Ghatak (2014) show that violence targeting civilians is associated with lower tax revenues.

There is also evidence that civil wars can lead states to invest in fiscal capacity. Slater (2010) shows there are positive effects of internal conflict on tax collection in Southeast Asia. Rodríguez-Franco (2016) documents qualitatively how Colombia’s urban elites began to support state-building through new taxes in the early 2000s. And Soifer (2015) links internal conflict to the extension of state presence across Latin America in the 19th century.

So why these conflicting results? One potential source of the ambiguity lies in the type of non-state actor dominating local violence and capturing state institutions. Many civil wars involve violent actors from both the left and the right (or from different ethnic groups), and their preferences over state service provision and revenue collection may vary. Specifically, in places where parties opposed to the state dominate violence, they may capture and erode institutions (Eaton 2006,



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López 2010). In contrast, where pro-state groups (or groups that benefit from a strong state) dominate, one might expect the opposite outcome even if there is fighting. More broadly speaking, the observed relationships between internal wars and state building at the country-level may mask different underlying local processes based on the types of non-state actors present in a given area.

So how can we learn more about the link between internal conflict and state building? Sub-national analysis provides one way to get at this question, but only given a particular set of circumstances. We require data from a place with multiple non-state groups whose political preferences vary, are clearly articulated, and are well understood. There must be uneven patterns of control by groups over space and across time, as well as variation in state presence, including revenue collection. There must be some local discretion in policies that indicate state capacity along with good data on local variation in violence, revenue collection, and service provision.

All of those conditions are present in Colombia. Local NGOs have developed high-precision data on conflict events for much of the country's most recent civil war (e.g. Restrepo et al. 2004).

Colombia's local governments have tremendous discretion over property and tax institutions. Mayors of the 1,122 municipalities are in charge of managing and updating the land registry. And city councils are in charge of establishing property tax rates, collection mechanisms, enforcement rules, and fines. Finally, the preferences of armed groups on property rights and local tax systems clearly differ.

In particular, right-wing paramilitaries favoured land owners and promoted the accumulation of large estates. These served as means to launder illegally acquired capital (through the drug trade, for example) or realise economies of scale in agricultural production and cattle ranching (Reyes Posada 2009, Ibáñez and Muñoz 2011). On the left-wing side, guerrilla groups aimed to replace what they characterised as an unjust state and claimed to be acting on behalf of peasants and workers. The guerrillas backed land invasions of state and private property in many areas (Steele 2017). FARC, the largest insurgency, also viewed state-recognised private property as illegitimate or unnecessary. In both cases these positions on property rights stemmed from long-held ideological commitments. They also make sense from the perspective of combatants trying to maximise their control over territory, and to mobilise supporters.

In a recent paper (Ch et al. 2018), we studied this situation closely, examining the correlation between which group dominated violence locally in a given period and tax revenues and institutions in the subsequent period. Because the Colombian civil war went through distinct identifiable phases, each of which might have its own dynamic, we examined four periods using the same statistical approach:

- **Period 1:** The period of dramatic FARC growth, 1988–1996
- **Period 2:** The expansion of right-wing paramilitaries, 1997–2002
- **Period 3:** The paramilitary demobilisation, 2003–2006
- **Period 4:** The steady re-establishment of state control, 2007–2010

Generally speaking, we found a negative relationship between cumulative past guerrilla violence in a municipality and tax revenues, as the top panel of Figure 1 shows. We also found a positive relationship between paramilitary violence and tax revenues, as the bottom panel shows. Put simply, the higher the level of past violence by a non-state armed group, the more local tax performance outcomes shift in the direction of that group's preference. Specifically, municipalities with greater guerrilla violence show less land formalisation and lower tax revenues in almost every period. In turn, municipalities with significant paramilitary violence had more land formalisation and higher tax receipts. Averaging out the estimates for the four conflict periods, we find that an increase in cumulative per capita guerrilla attacks from the median to the 90th percentile of the distribution is associated with an average 24% drop in per capita property tax (versus an 11% increase for paramilitary attacks). We also find that an equivalent change in guerrilla violence is associated with a 12% increase in land informality (versus 9% drop for paramilitary violence). These tax revenue changes mirrored changes in socio-economic outcomes, including economic activity and development levels as secondary enrolment rates.

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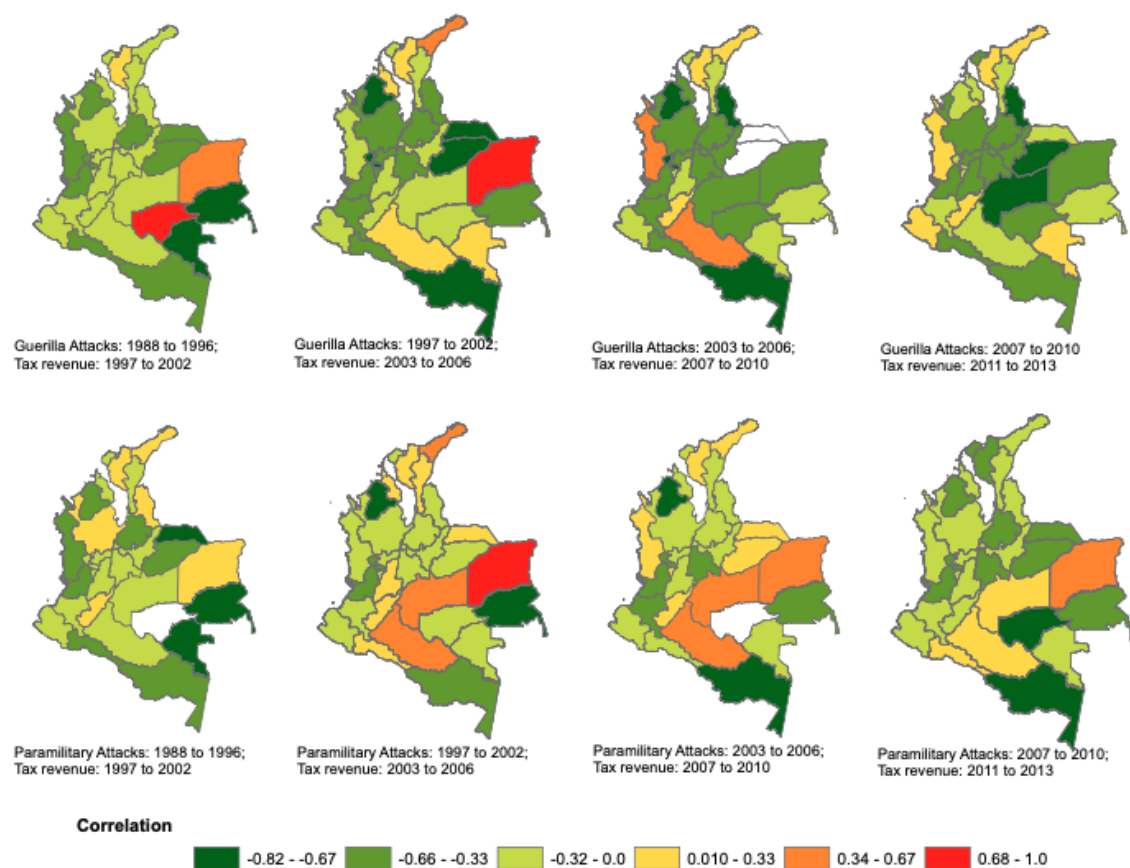
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Figure 1 Relationship between property tax revenues and attacks per armed group and time period across Colombian departments



Source: Ch et al. (2018)

So what drove these changes? The short answer is that we cannot be sure. What we can say is that it was probably not because the groups perpetrating local violence used their control to get favourable politicians elected. While it is true that municipalities with more paramilitary violence did have a greater probability of electing candidates from former President Uribe's right-wing political party coalition, that electoral mechanism explains a very small portion of the statistical relationship between right wing violence and tax revenues. And it's probably not the case that violence by the right led to economic gains, while violence from the left led to losses. Little of the relationship between violence and tax revenues runs through economic outcomes. We believe the most likely mechanism is that groups dominating local violence used intimidation and informal pressure to shift revenue collection and property rights in their favour.

This work provides a better understanding of contemporary state-building during internal wars. From an academic perspective, it is clear that armed groups have the ability to capture local state institutions and shape policies in their favour, so capture should not be an overlooked concern. Armed groups' preferences and civilian 'constituencies' are relevant for how they behave.

From the policy perspective, our research highlights the necessity of a disaggregated approach to policymaking in post-conflict reconstruction, one that takes into account differences between how non-state armed groups have shaped the areas they operated in. Our work also highlights a downside to fiscal decentralisation (see Eaton 2006 for a review of the pros and cons of these type of policies). Fiscal decentralisation might maximise political economy goals in stable countries but may generate drawbacks in places with ongoing violence where armed groups can take advantage of the delegation of fiscal choices to local officials vulnerable to coercion.

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