Design of Tax Systems and Corruption

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I. INTRODUCTION

There are several options available to governments for raising finances for bidding resources away from the other sectors of the economy and from other claimants to undertake their activities. The options include taxes, non-tax revenue such as fees, levies, cost recovery and user charges, and property and investment income, domestic and foreign borrowing including loans from the multilateral institutions, rents (called seigniorage) from government’s monopoly power to print currency and coins; sale of assets, including public enterprise, and domestic and foreign grants.

Taxes are a compulsory transfer of resources to the government from the rest of the economy. They may be levied in cash or in-kind (eg involving mandatory labor), and they can be explicit or implicit. Implicit taxes arise when a government acquires goods, services or assets at below market prices. Thus, if a government borrows household savings at rates below market prices, or returns to the public less than what it earns from investing these savings, then implicit tax would arise. Frequently, governments acquire land at below market prices, giving rise to implicit taxation on the owners at the time of acquisition. Some state enterprises incorporate tax elements in their pricing particularly if they have a monopoly power. Thus, pricing of state owned telecommunications companies, and of tobacco and alcohol products through state-owned stores may contain tax elements.

The definition of a “tax” is thus far from straight forward, even if conventional taxes are considered. However, in many countries, in addition to legally imposed taxes, there are also arbitrary and irregular tax-like levies imposed by the authorities. These are a part of a larger phenomenon of the necessity to make extra payments when interacting with government officials in many countries, particularly at the local level and at lower levels of bureaucracy. These also form a part of the burden of taxation and have socio-economic consequences. The irregular payments are not captured in the traditional data bases, including those involving government finance. When such irregular levies arise in-lieu of legally imposed taxes, the tax revenue collection will fall below what can be collected on objective grounds. When they arise in addition to the legally imposed taxes, the tax burden increases in an arbitrary and capricious manner, with detrimental effects on equity and efficiency in resource allocation.
In most countries, conventionally defined legal taxes and levies constitute a significant proportion of GDP, and finance major part of government expenditure. It is therefore essential that these systems be designed to achieve the appropriate trade-offs among revenue generation, allocation efficiency, equity, and administration and compliance costs.

This paper focuses on the design of the tax systems to minimize opportunities for corrupt behavior on the part of domestic or foreign taxpayers, bureaucrats and politicians in the developing countries. Corrupt behavior occurs whenever there is “abuse of power for private gain” (The World Bank, 1997, p. 102). The corrupt practices involve at least two parties. But often, intermediaries are also involved, and the beneficiary may be a party other than the tax official. Such transactions often involve complex pattern of actions and are usually found when the amounts involved are relatively large. The considerations involved in corrupt practices need not necessarily be direct transfer of money. They may involve a club membership or job for a family member, or non-pecuniary forms such as favorable publicity (OECD, 2000, p.3).

Thus, the study of incentives and opportunities to comply with the tax laws, analysis of legal framework within which the tax systems operate, study of the organization and incentives of the tax collection organizations, and overall social and political environment in which all three economic agents operate are all relevant for analyzing corruption relating to tax systems. This also suggests that corruption in any one aspect of the economy such as the tax system can not be addressed without addressing overall social environment and attitudes. It is therefore, important to draw on the insights from the literature on sociology and on psychology of taxation. In some societies tax evasion carries considerable social stigma, but in others this is not the case. Attitudinal change is therefore essential in the former if sustained reduction in corrupt practices in taxation is to be achieved.

As the paper is concerned with the developing countries, the circumstances facing the tax administrator in a typical developing country need to be kept in mind. The following quote nearly half a century ago by Surrey (quoted in Das-Gupta and Mookherjee, 1998, p.4)
The tax administrator on the one hand sees new burdens falling on his shoulders – new taxes being imposed and existing levies becoming more severe. He must collect more taxes, at higher rates, and from an ever-expanding body of taxpayers. On the other hand he finds himself saddled with a staff, which is insufficient, inexperienced, and poorly paid. He faces a public in large part unfamiliar with the tax knowledge and record keeping requirements, which a developing state must inevitably demand of its citizens. He cannot obtain the needed support from the legal and accounting professions. Finally, he must often demand the taxes from businesses and individuals with a deep-rooted suspicion ranging to contempt of the tax collector, for a public whose antagonism to tax payment, arising from a basic lack of confidence in the government, is almost the very antithesis of the attitude which must be cornerstone of every successful democratic tax system – that taxes are the price necessarily paid for civilized society. (Surrey, 1958, pp. 160-1)

The rest of the paper is organized as follows. The next section examines the reasons for designing tax systems to minimize corruption. This is followed by a brief overview of the avenues through which corrupt tax practices typically occur in a developing country (Section III). A discussion of the ways in which the tax system can be structured or designed to minimize corruption is undertaken in Section IV.

II. WHY MINIMIZE OPPORTUNITIES FOR CORRUPTION IN THE TAX SYSTEM?

There are several reasons why it is essential to minimize opportunities for corruption in the tax system. The first concerns the need for adequate revenue to finance government expenditure in the manner that is fiscally sustainable without adverse macro-economic consequences, and which provides fiscal flexibility in the future. Too great a proportion of government expenditure financed by borrowing may, for example, reduce future fiscal flexibility as debt servicing usually has a priority over other types of expenditure. Similarly, too rapid employment growth in the civil service could result in significant growth in future pension liabilities, reducing fiscal flexibility. Globalization has made certain types of expenditure (such as for infrastructure and human resource development) more imperative but has reduced the capacity to generate conventional tax revenue (Asher, 2001; Asher and Rajan, 2001).

If in addition to the globalization challenges, corruption reduces the revenue generation of the governments, this could seriously impact on fiscal sustainability
and flexibility. As debt servicing and civil service wages and pensions are usually non-discretionary expenditure, such reduced flexibility usually adversely impacts social sector and capital expenditure of the government. Thus, reducing corruption in the tax systems has become essential to generate sufficient revenue to finance government expenditure. This in turn is essential for any economy to meaningfully participate in the global economy in the 21st century.

The second reason concerns equity. Corrupt tax practices may impose additional tax burdens on usually ordinary citizens in an arbitrary and capricious manner, while benefiting those officials with impaired sense of their responsibilities and with low social conscience. The ordinary citizens also bear an indirect burden when there is collusion between certain individual or business taxpayers and tax officials which results in a reduction of the tax burden on the former, with the difference being shared by two or more parties. This reduces the tax base, necessitating higher tax rate on the rest of the taxpayers. The resulting re-distribution of tax burden and therefore income may permit the segment of the society to acquire wealth on the basis of unproductive activities rather than on the basis of skills, entrepreneurship, and innovations. If, the former then claims what the sociologists call the positional goods, economic dynamism and social norms of behavior may be adversely impacted. Corrupt practices thus violate public trust and corrode social capital (The World Bank, 1997, p.102). In the extreme cases, such a situation could seriously erode social cohesion and give rise to political instability. There are even occasional cases in some countries (such as China, Indonesia, and Vietnam) where violent clashes have occurred between the Provincial and local tax administrations on the one hand and farmers and villagers on the other. (Eckholm, 2001, Asher and Heij, 1999).

The third reason concerns economic efficiency. Corruption distorts the relative tax burdens and imposes higher welfare costs on those paying taxes as their rates are higher due to the erosion of the tax base due to corruption. A well know proposition in public finance states that, other things equal, the welfare costs rise by the square of the marginal tax rate. It is for this reason that low marginal tax rates (along with broad base) are usually recommended as a part of tax reform.
It is sometimes argued that if the tax (or regulatory) system imposes excessive burdens, is inefficient, or if taxes (or regulation) are imposed by governments lacking in legitimacy, it may be appropriate for individuals and businesses to engage in corrupt practices to enhance efficiency and undermine the illegitimate regime. While in some specific isolated cases, tax (or regulation) may indeed be inefficient, a routine tolerance on the part of the society of such behavior, or granting of the right to decide what is fair and efficient to individuals or specific domestic or foreign business, is certainly not a desirable route to developing viable and sustainable economies or societies. Often, such rationale is self-serving, and the dynamics of such a situation is unlikely to lead to benign outcomes (Rose-Ackerman, 1999, pp. 21-25).

The fourth reason is that in the medium term, corruption is likely to adversely impact domestic and foreign investment (The World Bank, 1997, pp. 102-103); lead to distortion in the types of investment (eg casinos, and luxury developments and golf courses instead of manufacturing, infrastructure, and new economy activities); and by undermining social amenities, make it more difficult to retain and attract talent (Tanzi and Davoodi, 2000).

Corrupt tax practices are also likely to impact small and medium enterprises (SMEs) more severely than large firms. In most economies, particularly in the developing countries, it is the SMEs, which provide the bulk of employment and are more market responsive than then large firms. The SMEs in many developing countries are also more export-oriented than large firms. In a 1999 survey of some 3000 enterprises in 20 transition economics, conducted by the European Bank for Reconstruction and Development (EBRD) and the World Bank, it was found that bribes (which include corrupt tax practices) act like a regressive tax; the bribes paid by smaller firms (those with less than 49 employees) amounted to about 5 percent of their annual revenue compared with 4 percent for medium-size firms (between 50 and 499 employees), and slightly less than 3 percent for large firms (those with employees of more than 500) (Tanzi and Davoodi, 2000, p. 8). Smaller firms in the study also paid bribes more frequently then medium size and large firms; and so did the newly privatized state firms.
Thus, lessening of the corrupt tax practices, particularly those impacting on the everyday life of ordinary individuals, and on the SMEs, could itself act as a powerful incentive for desirable economic behavior, improve cost competitiveness, and help sustain growth.

The fifth reason concerns evolving international regime concerning fiscal governance. This is particularly relevant for those developing countries, which are heavily reliant on multilateral institutions for financial and technical assistance. The International Monetary Fund (IMF) has set up fiscal transparency code, which the member countries will need to follow as part of the IMF membership, and which may become a routine part of the conditionality. The tax reform projects in which the World Bank assisted with a loan during the 1990s did not have strengthening of anti-corruption practices as major element, even when there was a major administration component. Thus, only 4.7 percent of the 43 such projects had anti-corruption focus, while nearly 40 percent focused in revenue enhancement and strengthening of administrative institutions (Barbone et al, 1999, Table 2, p.4). However, in recent years, particularly since the 1997 East Asian economics crisis, both the World Bank and the Asian Development Bank have increased their emphasis on governance and institutional development issues. Thus, corrupt tax practices are not as easily likely to be ignored by them in the future as was the case earlier. Tax policy (and tax administration) autonomy of countries, particularly low-income countries, has clearly declined in recent years. Thus, they need to be perceived to be making good faith efforts in tackling corrupt tax practices.

The sixth and final reason concerns the impact of corrupt tax practices on balance of payments and the exchange rate. Often, the recipients abroad send the money obtained from corrupt tax practices, mainly in the financial centers located in high-income countries and in tax heavens with strong bank secrecy protection. These capital outflows negatively impact on the balance of payment and could result in currency volatility.

What responsibilities should the recipient countries in the financial centers and tax heavens bear in such financial outflow? Should the countries receiving funds arising from corrupt tax practices (and from tax evasion) bear any responsibility? Under current international practices, the financial centers receiving such funds do not bear
any responsibility. Recently, US banks have been alleged to have been involved directly or indirectly in handling money from a range of illegal activities, such as narcotics, prostitutions, illegal gambling and others. In this case, linkages between corrupt tax practices, criminal activities, and criminals are even more direct.

The main device used has been opening of correspondent accounts in the U.S. for shell banks with no physical presence (Beckett, p 2001). While laws for money laundering are being tightened, prospects for accountability of financial centers in receiving funds from corrupt tax practices (and from tax evasion) are very limited. Indeed, recently the U.S. ended its support for OECD’s crackdown on tax heavens (Milbank, 2001).

The emphasis however should not be solely on the developing countries. A 1999 survey ranking 19 leading exporting countries according to their propensity to pay bribes is in the right direction in redressing the current imbalance (http://www.transparency.org.my/resource/bpi.html). East Asian countries, China (including Hong Kong), were found to have the highest propensity to pay bribes, followed by South Korea, Taiwan, Italy, Malaysia, and Japan. Such survey not only needs to be undertaken annually, but also its scope needs to be widened and the results publicized more widely. The aim should be to bring more countries under the Organization for Economic Cooperation and Development (OECD) Convention on Combating Bribery of Foreign Public Officials, and finding effective international mechanism to deter such practices. (OECD, 2000). This is because while generally those countries that have ratified the OECD convention had low propensity to pay bribes, South Korea and Japan were prominent exceptions. So mere ratification of the Convention is not sufficient.

Thus, there is sound macro and micro economic reasons for addressing corrupt tax practices in the developing countries.

III. AVENUES OF CORRUPT TAX PRACTICES

Before discussing various avenues through which corrupt tax practices may occur, it may be useful to distinguish between tax avoidance and tax evasion. The former is a situation in which the taxpayer makes use of all available loopholes and ambiguities
in the tax statutes and implementing regulations, but there is no willful violation of the law. It is therefore referred to as tax planning. Those able to shape the tax statutes and implementing regulations could therefore reap substantial pecuniary benefits. This is a common practice in countries at all income levels.

Tax evasion is illegal and carries with it the possible imposition of penalties if caught. Thus, if there existed capital controls on outflows and capital flight were done through the parallel or underground market that would be tax evasion.

Revenue lost from tax avoidance and evasion is usually much larger than tax revenue lost through corrupt practices, which involve collusion between the taxpayers on the one hand, and the government officials (and politicians) on the other. Thus, passing through green channel in customs even when there are some dutiable items being brought into the country; or a business keeping multiple book of accounts for the purposes of under-reporting of taxable income represent tax evasion and loss of revenue. These however are not corrupt practices unless collusion with the tax officials takes place. Thus, as with any exchange, there are two or more parties to the corrupt practices.

Lax administration, either deliberately as a matter of political or bureaucratic decisions, or more subtly arising from the lack of necessary investment in human and material (including information technology) resources, also often results in erosion of tax revenue and arbitrary and capricious efficiency and equity impacts. Complex taxes such as the income tax, property tax, and value-added tax (VAT) are more likely to experience lax or uneven administration.

Tendency for corrupt tax practices varies among different elements of the tax system. Thus corrupt tax practices seem particularly prominent in granting and monitoring of tax incentives, and in the imposition of foreign trade taxes. In many developing countries, routine activities, such as obtaining or renewing of drivers’ licenses, inspections designed to ensure compliance with the relevant rules and regulations; registration of birth and death, obtaining positional goods with large excess demand such as fixed-line telephones, are also quite prone to corrupt practices.
The key common element is the considerable discretion provided to the officials, and the potential for large benefit to those wanting the officials to use it in their favor. Thus, those engaging in corrupt practices gain at the expense of the rest of the economy and society. Many countries have intricate and complex rules for sharing such illegal gains among the bureaucracy and politicians. While the latter are at least partially accountable at election times (provided elections are contestable events), the bureaucracy is often even less accountable. This asymmetry needs to be addressed.

In the case of fiscal incentives, relatively high level officials and politicians are more likely to be involved in corrupt practices. In the case of foreign trade taxes, and routine activities, lower level officials are also likely to be involved, and they may share the gains with those higher-ups in the authority. It is the lower level everyday corrupt tax practices that often erode public confidence in the governmental institutions, and are therefore more corrosive. The damage done by subtle and often complex and hidden abuse of power should also not be underestimated.

It is essential to recognize that at least a tacit consent of the taxpayers is needed to administer any tax system (or law). It is here that linkages between tax compliance and administration on the one hand and government provision of services, and perceptions of its effectiveness are strongly manifested.

Tanzi has identified the following as examples of corrupt practices undertaken by tax administration officials (1998, p. 114).

- provision of certificates of exemption from tax to persons who would not otherwise qualify;
- deletion or removal of a taxpayer’s records from the tax administration’s registration, filing and accounting systems;
- provision of confidential tax return information to a taxpayer’s business competitors;
- creation of multiple false taxpayer identifications to facilitate tax fraud;
- write-off of a tax debt without justifications;
- closure of a tax audit without any adjustment being made or penalties being imposed for an evaded liability;
- manipulation of audit selection.
There are also various ways in which customs administration officials often engage in corrupt tax practices. These have been identified by Tanzi (1998, p. 114) as the following:

- facilitating the smuggling of goods across a national border to avoid tax and duty payments;
- facilitating the avoidance or understatement of a tax or duty liability through acceptance of an under valuation or misclassification of goods in the processing of a customs entry;
- allowing goods that are held in a bonded warehouse to be released for consumption in the domestic market without payment of tax or duty;
- facilitating false tax and duty refund claims through certification of the export of goods that have been consumed in the domestic market or than have not been produced at all.

Corrupt practices, similar to those for the customs taxes, also occur with respect to the excise and sales taxes. Excise taxes are on production rather than on sale, and physical checks are not uncommon in excise taxes. There are thus incentives for corrupt tax practices similar to those for customs. In a federal country with multiple excise or sales tax jurisdictions, tax arbitraging because of multiple rates provides as added opportunity for avoidance and sometimes for corrupt tax practices. In the case of VAT, disproportionate credit for inputs is a common form of corrupt practice, especially when the tax administration is weak and has low capacity. Multiple tax brackets or categories, and unrealistic level of taxes could also provide opportunities for corrupt tax practices.

Many tax policy experts therefore regard tax administration as essentially determining tax policy in many low-income countries.

IV DESIGNING TAX SYSTEMS TO MINIMIZE CORRUPT PRACTICES

It is evident from the discussion in the previous sections that issues surrounding corrupt tax practices are complex, and not amenable to quick or easy solutions. Resort to one-off measures such as tax amnesties, or withdrawing from circulation
large denomination currency notes thus have had predictably disappointing results in countries around the world. Many countries have also had committees of enquiry, which have dealt with tax reform issues, including corrupt tax practices. The result in these cases have been mixed. It is increasingly realized that without fundamental complementary changes, tax reforms by themselves do not have long lasting impact.

As Bowles has noted:

“In many cases political corruption is at least as serious an issue as corruption of the tax bureaucracy. Low salaries for tax official, political protection of prominent tax evaders, poor monitoring of junior officials, high tax rates, high levels of discretion for the tax official, and poor information generally are some of the reasons commentators are inclined to give for the persistence of extensive corruption in many countries in Africa, Asia, and Latin America” (1998, p.82).

At what point are the policymakers, bureaucracies, and taxpayers ready to make fundamental changes towards reducing corrupt practices is a question to which there is a no prior or easy answer. As noted in the previous section, globalization has increased the urgency for such fundamental changes, but it is the internal dynamics of each society, which will determine whether the needed changes, will be made.

Measures to reduce corrupt tax practices are needed on a variety of fronts, and they need to be applied on a persistent basis over a long term. (The World Bank, 1997, p. 105). It is essential that as with tax reform, addressing corrupt tax practices be regarded as a process and not as an event. Basic institutional reforms are needed. However, the knowledge about how to bring about appropriate institutions is still at an early stage. (Rodrik, 1999). All parties, including the multilateral agencies need to develop a sense of humility in this area.

It is also essential to distinguish between an ideal tax system and tax reform. The latter involves improving the existing trade-offs between revenue generation, equity, efficiency, and tax administration and compliance. This assumes existing tax system and entrenched practices. Thus, political economy aspects, and political and leadership skills are essential in fundamentally tackling the causes of corrupt tax practices. This task is particularly challenging in the economies in transition where
radical changes in relations between the state, taxpayers, and tax officials are contemplated when shifting from a centrally planned to a market economy. In the transition economies, ensuring that the officials and others do not misappropriate state assets is also a hugely challenging task because of unclear nature of property rights and poor enforcement (Tanzi and Davoodi, 2000).

In any explanation of the corruption in general, as well as corrupt tax practices in particular, principal-agent model (or agency theory) is frequently used (Jain, 1998; Rose-Ackerman, 1999). Principal is usually a person or organization on whose behalf the agent undertake various tasks. The key is to design incentive structures in such a way that the agent acts in the interest of the principal rather than in his or her own interest. This involves reducing opportunities for corruption, and strengthening mechanisms for monitoring and punishment (The World Bank, 1997, pp 105-109).

The main ways in which opportunities for corruption may be reduced are:

• Clarify and streamline laws and procedures, which reduce official discretion. In many developing countries, laws dating back to the colonial times have not been updated for the modern times. Indeed, it is essential to undertake reform of tax design and introduction of new tax statutes simultaneously.
• Ensure that tax rates are realistic in relation to trade and profit margins, and in relation to asset values.
• Do not attempt to overly fine-tune either the rate or the base structure of a tax, particularly of income, sales, and excise taxes, to achieve presumed equity impacts.
• Make greater use of withholding provisions, particularly for capital income. This could be combined with gradual shift towards self-assessment of taxes, backed by enhancing auditing capabilities of the tax administration.
• Make tax rules and regulations more transparent. In the case of taxes (and charges) simple requirements such as posting of various charges (including for forms) prominently; only accepting machine-printed receipts; and using IT to disseminate forms and information could help minimize information asymmetry and reduce discretionary power of the low-level bureaucrats. A tax guide written in understandable local language could help the taxpayers to negotiate daily routines. The guide should also include a code of conduct for tax officials and politicians in charge of Ministries with revenue generating responsibilities. The
central authorities should also fight illegal local levies, or illegal payments at lower levels (Gilley, 2001).

- The use of IT for E-government is now being attempted in many countries around the world at all income levels. Among the high-income countries, Singapore, U.K., Chile, and the U.S. have made significant strides in E-governance (Dass, 2000). In the U.S. there are several private sector run sites that assist in E-governance. Thus, a site called [www.govworks.com](http://www.govworks.com) collects local taxes, fines, and utility bills for 3600 municipalities across the country.

  Among low-income countries, India (particularly the states of Andhra Pradesh, Tamil Nadu, Maharashtra, and Madhya Pradesh) is in the early stages of using E-governance. The expectation is that such initiatives will reduce the discretionary power of local officials, reduce corrupt practices relating to taxation and delivery of government services, reduce transactions costs, and increase transparency (Das, 2000). These in turn will reduce the opportunity to engage in corrupt tax and other practices, and bring down the bribery price.

  This suggests that low-income countries with certain capabilities and requisite political determination can use E-governance. Information is indeed empowerment in tax administration and compliance, but it should be symmetric rather than asymmetric.

- Improve transparency and accountability in budget preparation, execution, and oversight.

- Adopt administrative reforms which introduce some competitive pressures in the workings of government departments and enterprises and, which provide management and public with the appropriate information to assess performance and service quality.

- Devise a scheme to recognize taxpayers, both individual and companies, which have a good record over a considerable period. Such schemes are in operation in South Korea and India.

- Make payments for bribes non-deductible for domestic and foreign businesses (OECD, 2000).

Possible ways for strengthening mechanisms for monitoring and punishment include the following:

- Strengthen parliamentary oversight, and independent audit and investigative bodies.
• Consider tax ombudsman and special tribunals and tax courts to speed up resolution of tax disputes.

• Review assignment of fiscal responsibilities and resources at various levels of government.

• Use credit-rating agencies, insurance companies, and others as indirect regulators and instruments of making information available on government finances and tax practices to wider range of economic agents and public. This can be done for example by developing genuine market for state and municipal bonds; and having a competitive insurance sector.

• Consider adopting country and context specific methods to expand the number of taxpayers in the country. This is essential because if the number is well below its potential, burden on each taxpayer is likely to be well above the average. Thus, since 1998, Indian has implemented regulations under which an individual satisfying even one of six criteria (called one-in-six scheme), must file an individual income tax return even if the income is below the threshold level. This has increased the number of individual income tax assesses from about 15 million to around 25 million. This number is expected to increase to around 40 million in the next few years. India has also required all companies to file income tax returns. This would help in administration of excise, sales, and other taxes as many unregistered companies often avoid or evade not just the income tax, but also other taxes. This again underlines the need for developing databases on taxpayers from a variety of sources.

The multilateral institutions have considerable expertise in technical aspects of design and administration of tax systems. However, their advice needs to be measured against the requirements of specific localized context and needs. (Rodrik, 1999). Encouragement of indigenous fiscal research and analysis capability is essential for adapting external advice to local needs and context, and for the art of appropriate lesson drawing.

A suggestion by Vito Tanzi, influential former Director of the IMF’s Fiscal Affairs Department, for setting up a World Tax Organization (WTO), is unlikely to be accepted as sovereignty in tax policy is highly prized by countries at all income levels; and developing countries are unlikely to support another intrusive and limiting international organization in which they will have little influence or leverage (Asher
and Rajan, 2001). So for the foreseeable future, policymakers and tax administrators will be facing current institutional arrangements, and will need to devise their strategies and tactics to address corrupt tax practices accordingly.

It should however be recognized that tax systems and the extent of corrupt tax practices in any country do reflect the overall policy environment and social mores and norms of the country. Thus, norms of public accountability, transparency, and socially desirable (rather than only privately lucrative) behavior need to be encouraged. Ultimately, social and political ethos and values can not be separated from economic management in general, and fiscal systems, including tax systems, in particular.

REFERENCES


ENDNOTES

1 For a survey of the static economic consequences of each of the options, see Rajan and Asher, 1997.

2 When state enterprises sell below market prices, negative taxes or subsidies arise. An analysis of their economic implications is however beyond the scope of this paper. The larger issues of corrupt practices in government expenditure management, and urgent need to improve public expenditure efficiency also are not directly addressed in this paper. See however, (The World Bank, 2000, ch.5; Asher, 2001)

3 Thus, for the 1993-97 period, tax revenue to GDP ratio averaged 17.1 percent, and accounted for about three-fourth of total revenue in five Southeast Asian countries, namely Indonesia, Malaysia, Philippines, Singapore, and Thailand. During the period, the share of total expenditure and net lending financed from the tax revenue averaged 88 percent. (Asher, 2001, Tables 1 and 2). In some countries, such as Indonesia, there is also significant proportion of government activities, which are not included in the official budget. These "off-budget" activities, by their nature, are more difficult to analyze, but provide significant potential for corrupt practices because of low transparency and accountability.

4 The total may not add up to 100.0 as a project may have more than one objective.

5 A more vexing question is the share of responsibility in corrupt tax (and government expenditure) practices in the countries with which the multilateral institutions have continuing lending programs. The amounts involved are not small. Thus, in Indonesia it is estimated that about US$10 billion, roughly a third of all World Bank loans, was misappropriated under the New Order regime of President Suharto (Winters, 2001). It has been asserted that the Bank was fully aware of its loans being misappropriated, but continued with its support of the lending programs (Winters, 2001). Under such circumstances, should the taxpayers and people of Indonesia bear the full burden of servicing the resulting debt, or should the World Bank and its shareholders also bear a part of the burden? This issue needs to be debated more widely, transparently, and objectively than has been the case so far.
In some cases, governments attempt to impede natural cross-border trade flows by making them illegal. This would naturally give rise to smuggling and consequent loss of tax revenue to the concerned governments. Thus, unaccounted cross border trade between India and Pakistan is estimated to be US$1 billion, several times the official trade (Joshi, 2001). The illegal trade is even larger if bilateral trade through third countries is included. The illegal trade is giving rise to loss of significant revenue from import duties and other taxes to both countries at a time when they are experiencing severe fiscal stringency. It is also making the two countries less competitive than they otherwise would be. This implication is of increasing significance in the Post Cold War globalizing international environment. Normalizing cross-border trade, with realistic level of import duties, would thus be beneficial to both countries.

Tax amnesties may differ markedly in their results depending on whether they are perceived to be only one-time, intermittent, or permanent, whether they were anticipated by the taxpayers or not, and whether they signify anything about future tax enforcement, and possible consequences from others when property rights are not fully secure (Das-Gupta and Mookherjee, 1998, p. 127).

The discussion here draws substantially but not wholly from The World Bank (1997), and The World Bank (2000).

Ibid.

The six criteria are occupation of immovable property, owning or leasing of a motor vehicle, subscriber to a telephone, travel abroad, holder of a credit card, and membership of a club with fees above a threshold level. The details may be found in http://www.etinvest.com/ettax/onebysix.htm.