

The Design of Tax Systems and Corruption

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Introduction

Governments have several options at hand to finance their activities and pursue their fiscal policy. These options include the imposition of taxes and the generation of non-tax revenues through fees, levies, cost recovery and user charges, property and investment income, domestic and foreign borrowing (including loans from multilateral institutions), seigniorage (rents generated from the government's monopoly power to print currency and coins), the sale of government assets (including the sale of public enterprises) and domestic and foreign grants. **1**

In most countries, conventionally defined legal taxes and levies² constitute a significant proportion of GDP, and finance a major part of government expenditure. **3** It is therefore essential that tax systems be designed to achieve the appropriate trade-offs among revenue generation, allocation efficiency, equity, and administration and compliance costs.

However, in many countries, in addition to legally imposed taxes there are also arbitrary and irregular tax-like levies imposed by the authorities. These levies are a part of a larger phenomenon involving the need to make extra payments when interacting with government officials in many countries, particularly at the local level and at the lower levels of bureaucracy. These levies also form a part of the burden of taxation and have socio-economic consequences. Nevertheless, these irregular payments are not captured in the traditional economic databases, 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.

This paper is concerned with the design of tax systems and corruption in developing countries. As such, the limitations facing the tax administrator in a typical developing country need to be kept in mind. The following quote, from nearly half a century ago,

paints a comprehensive picture of the circumstances facing the tax administrator in a typical developing country:

The tax administrator on the one hand sees new burdens falling on his shoulders—new taxes being imposed and existing levels 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 the cornerstone of every successful democratic tax system—that taxes are the price necessary for civilized society. (Surrey, 1958, pp. 160-61, as quoted in Das-Gupta and Mookherjee, 1998, p.4).

In the following sections, this paper will attempt to provide some insights into the costs and causes of corruption in developing countries. It will also attempt to provide a brief overview of the strategies and approaches that governments can adopt to minimize corrupt tax practices and enhance the effectiveness of their tax systems. This discussion will rest on the fundamental premise that in order to better understand corrupt tax practices in the developing countries, it is necessary to study the incentives and opportunities to comply with the tax laws, as well the legal framework within which tax systems operate, the organizations and incentives for tax collection organizations, and the overall social and political environment in which economic agents operate.

This paper also presupposes that it is important to draw on the insights from the literature on the sociology and psychology of taxation when crafting anti-corruption efforts. Corruption in the tax system of developing countries cannot be addressed without addressing the overall social environment and attitudes held in a society. In some societies tax evasion carries considerable social stigma, but in others this is not the case. Attitudinal change is therefore an essential ingredient in achieving the sustained reduction in corrupt practices relating to taxation

Reasons for Minimizing Opportunities for Corruption

There are several reasons that make it essential to minimize the opportunities for corruption in the tax system. The first reason concerns the role taxes can play in generating revenues to finance government expenditure. Taxes need to be imposed in a manner that is not only fiscally sustainable (without adverse macro-economic consequences), but 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 priority over other types of expenditure. Similarly, if employment growth in the civil service takes place too fast, growth in future

pension liabilities may reduce fiscal flexibility. While globalization has made certain types of expenditure (such as expenditures for infrastructure and human resource development) more imperative, it has reduced government's capacity to generate conventional tax revenues (Asher, 2001; Asher and Rajan, 2001).

By reducing the potential revenue generation capability of government, corruption can have a serious impact on fiscal sustainability and flexibility. As debt servicing and civil service wages and pensions are usually a non-discretionary expenditure, reduced fiscal flexibility usually adversely impacts the social sector and capital expenditure of government. For this reason, reducing corruption in the tax system has become an essential prerequisite if government is 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 ordinary citizens in an arbitrary and capricious manner, while enriching government officials with an impaired sense of public service and responsibility. Ordinary citizens also bear an indirect burden when individuals or businesses collude with tax officials in order to reduce their tax burden. Such collusion reduces the tax base and leads to the imposition of a higher tax rate on the rest of the taxpayers. Moreover, the resulting re-distribution of the tax burden (and therefore income) may allow dishonest taxpayers to acquire wealth on the basis of unproductive activities rather than on the basis of skills, entrepreneurship and innovations. If these colluding taxpayers then claim what sociologists call "positional goods" such as desirable housing and cars; club membership; admission for their children in prestigious schools and universities; and civic and political leadership positions with high visibility,(that is?...), economic dynamism and social norms of behaviour may be adversely impacted. Corrupt practices thus violate the public trust and corrode social capital (The World Bank, 1997, p. 102). In extreme cases, these practices can seriously erode social cohesion and give rise to political instability. Recent examples can be found in China, Indonesia, and Vietnam, where violent clashes have at times taken place between the Provincial and local tax administrations on the one hand, and farmers and villagers on the other (Eckholm, 2001; Asher and Heij, 1999 [Asher and Heiji as in Ref?]). It is Asher and Heij. So please change the reference entry.

The third reason concerns economic efficiency. In systems beset by corruption, individuals and businesses paying their full share of taxes are saddled with higher tax rates because of an eroded tax base. Thus, corruption distorts the relative tax burdens of individuals and businesses, and imposes higher welfare costs on honest taxpayers. A well-known proposition in public finance states that, other things being equal, welfare costs rise by the square of the marginal tax rate. It is for this reason that low marginal tax rates (along with a broad tax base) are usually recommended as apart (delete the word apart and substitute an essential element) 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, the tax (or regulation) may indeed be inefficient, a routine tolerance on the part of society of such behaviour, or the granting of the right to decide what is fair and efficient to individuals or specific domestic or foreign businesses, is certainly not a desirable route to developing viable and sustainable economies or societies. Often, such a rationale is self-serving, and the dynamics of such a situation is unlikely to lead to benign outcomes (Rose-Ackerman, 1999, pp.21-25). [such as? (I am not sure what such as? Refers to. But your sentence in Green is fine, but no question mark needed at the end. Corrupt tax practices far from favouring entrepreneurs or organizations that are efficient, often end up favouring inefficient, well entrenched groups who know how to make use of the political process, who to bribe and how to manipulate the political system to their advantage?]

The fourth reason concerns the level and quality of investment. In the medium-term, corruption is not only likely to adversely impact domestic and foreign investment (The World Bank, 1997, pp.102-103), but to distort the types of investment undertaken in a country. Thus, for example, in a highly corrupt context, investments in casinos, luxury developments, and golf courses will be favoured over investments in manufacturing, infrastructure, and new economy activities. In addition, by undermining social amenities, corruption makes it more difficult to retain and attract talent (Tanzi and Davoodi, 2000).

Corrupt tax practices are also likely to negatively impact small- and medium-sized enterprises (SMEs) more severely than large firms. In most economies, and particularly in the developing countries, the SMEs provide the bulk of employment and are more market responsive. In addition, in many developing countries the SMEs tend to be more export-oriented than large firms. In a 1999 survey conducted by the European Bank for Reconstruction and Development (EBRD) on some 3000 enterprises in 20 transition economies, it was found that “bribes” (a category which includes corrupt tax practices) act like a regressive tax. The bribes paid by smaller firms (those with less than 49 employees) amounted to 5 percent of their annual revenue. In contrast, bribes paid by medium-sized firms (those with between 50 and 499 employees) amounted to 4 percent of their annual revenue, while those paid by larger firms (those with more than 500 employees) amounted to slightly less than 3 percent of the annual revenue of the large firms (Tanzi and Davoodi, 2000, p.8). Smaller firms (as well as newly privatized state firms) in the study also paid bribes more frequently than the medium-sized or larger firms.

The fifth reason concerns the emergence of an evolving international regime of good fiscal governance. Today, recipients of international aid must be perceived to be making good faith efforts in tackling corrupt practices. This development is particularly relevant for those developing countries that are heavily reliant on multilateral institutions for financial and technical assistance. The International Monetary Fund (IMF) has set up a fiscal transparency code that member countries will need to follow as part of IMF membership and which may become a routine part of conditionality. In addition, in recent years, and particularly since the 1997 East Asian economic crisis, both the World Bank

and the Asian Development Bank have increased their emphasis on governance and institutional development issues. In the 1990s, the World Bank's involvement in tax reform projects did not have strengthening of anti-corruption practices as a major element, even when there was a major administrative reform component. Thus, only 4.7 percent of the 43 tax reform projects the World Bank undertook during that period had an anti-corruption focus, while nearly 40 percent focused on revenue enhancement and the strengthening of administrative institutions ⁴ (Barbone et al., 1999, p.4). However, with the World Bank's change in emphasis, corrupt tax practices are not as likely to be ignored in future as was the case earlier. ⁵ As a result of all these changes, the autonomy of countries, particularly low-income countries, to set tax policy (and tax administration) has clearly declined in recent years.

The sixth and final reason concerns the impact of corrupt tax practices on a country's balance of payments and exchange rates. Often, officials and businesses [recipients abroad ?](The sentence as it stands without the GREEN words is fine) send money obtained from corrupt tax practices to financial centers located in high-income countries and in tax havens with strong bank secrecy protection. These capital outflows have a negative impact on the balance of payments and could pave the way for currency volatility.

In addition, the link between corrupt tax practices, criminal activities and criminals is often (instead of often use the words in some cases) very direct. To illustrate, recently, US banks have allegedly been involved directly or indirectly in handling money from a range of illegal activities (including the trade in narcotics, prostitution, and illegal gambling). The main device used for these transfers has been the opening of correspondent accounts in the United States for shell banks with no physical presence (Beckett, P., 2001). While laws for money laundering are being tightened, the prospects for accountability for the financial centers in receiving funds from corrupt practices (and from tax evasion) are very limited. Indeed, recently, the United States ended its support for the OECD's crackdown on tax havens (Milbank, 2001).

To sum things up, there are sound macro or micro economic reasons for combating corrupt tax practices in the developing countries. Lessening, if not eradicating fully corrupt tax practices (particularly those impacting on ordinary individuals and SMEs) could act as a powerful incentive for desirable economic behaviour, improve cost competitiveness and help sustain growth.

Avenues for Corrupt Tax Practices

Before discussing the various avenues through which corrupt tax practices may occur, it may be useful to distinguish between tax avoidance, tax evasion and corrupt tax

practices. Tax avoidance takes place when the taxpayer makes use of all available loopholes and ambiguities in the tax statutes and implementing regulations in order to lower his tax burden, but does not willfully violate the law. This strategy is referred to as tax planning, and is routinely practiced in all countries, involving very reputable firms with high priced professionals.. Thus, individuals, businesses or groups that are able to shape the tax statutes and implementing regulations can reap substantial pecuniary benefits. Not surprisingly, then, lobbying and other efforts to influence the design of tax arrangements is a common practice in many countries at all income levels. [? Does “This is a common practice” refer to attempting to influence tax statutes and regulations? Or does it refer to tax planning? Both?](THIS here does refer to attempting to influence tax statutes and regulations).

Tax evasion, in contrast, involves illegal actions. A tax evader, therefore, faces the possible imposition of penalties if caught. A typical example of tax evasion would involve a taxpayer’s attempts to circumvent capital controls by making use of the parallel or underground market to move his capital out of the country.

For their part, corrupt tax practices involve collusion between taxpayers on the one hand, and government officials (and politicians) on the other. Passing through the green channel in customs when there are some dutiable items being brought into the country, or keeping multiple book accounts in order to under-report taxable income represent cases of tax evasion. However, these cases do not amount to corrupt practices unless collusion with tax officials takes place. As with any exchange, two or more parties need to be involved in corrupt practices.

The amount of revenue lost from tax avoidance and evasion is usually much larger than the revenue lost through corrupt tax practices. Lax administration also often results in the erosion of tax revenue, and in the imposition of deleterious and capricious efficiency and equity outcomes. Lax administration can result from deliberate political or bureaucratic decisions, or more subtly arise from the lack of necessary investments in human and material (including information technology) resources. Complex taxes such as the income tax, property tax, and value-added tax (VAT) are more likely to fall victim to lax or uneven administration. Globalization and the financial crisis have indeed introduced the OECD level complexity to the tax systems, particularly for the income and sales taxes, of the developing countries(Asher and Rajan, 2001; Asher and Heij, 1999). Tax administrations in these countries will therefore need to devise ways to cope with the resulting complexity.

Corrupt tax practices are frequently a prominent feature in the granting and monitoring of tax incentives, and in the imposition of foreign trade taxes in many countries. In many developing countries, routine activities, such as obtaining or renewing drivers’ licenses, passing inspections designed to ensure compliance with relevant rules and regulations, registering the birth or death of a family member, or obtaining positional goods with large excess demands (such as fixed-line telephones) are also quite prone to corrupt practices.

Tanzi has identified the following as common examples of corrupt practices undertaken by tax administration officials (1998, p.114 [or is it Tanzi 1999 as in Ref?])[⊗] It is 1999)

- The provision of certificates of exemption from tax persons who would not otherwise qualify.
- The deletion or removal of a taxpayer's records from the tax administration's registration, filing and accounting systems.
- The provision of confidential tax return information to a taxpayer's business competitors.
- The creation of multiple false taxpayer identifications to facilitate tax fraud.
- The write-off of a tax debt without justification.
- The closure of a tax audit without any adjustment being made or penalties being imposed for an evaded liability.

There are also various ways in which customs administration officials often engage in corrupt tax practices. Tanzi (1998, p.114 [or is it Tanzi 1999 as in Ref?])(It is 1999) identifies these corrupt transactions as follows:

- Facilitating the smuggling of goods across a national border to avoid tax and duty payments. **6**
- Facilitating the avoidance or understatement of a tax or duty liability through the 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 the certification of the export of goods that have been consumed in the domestic market or that have not been produced at all.

Corrupt practices, akin to those seen in relation to customs taxes, also can be seen in relation to excise and sales taxes. Excise taxes are imposed on the production of goods rather than on the sale of goods. Moreover, physical checks are not an uncommon feature in the imposition of excise taxes. Thus the area of excise taxes provides incentives for corrupt tax practices similar to those found in the area of customs. The existence of multiple excise or sales tax jurisdictions in countries with a federal system of governance, create additional opportunities for avoidance and sometimes, for corrupt practices. In the case of value added taxes (VAT), the granting of a disproportionate credit for inputs is a common corrupt practice, especially where the tax administration is weak and has low enforcement capabilities. (Your Green Words loe enforcement capacities are fine, other green words not needed.[?low capacity? Low commitment to public service? Low enforcement capabilities? Low levels of professionalism?]) In addition, multiple tax brackets or categories, and an unrealistic level of taxation can also provide opportunities for corrupt tax practices.

In short, the key common elements(The term elements is fine) [sources?] of corruption in the tax system are the considerable discretion provided to officials, the large potential gains (high rents) to be reaped, and the lack of adequate monitoring and reporting mechanisms. Taxpayers and officials who engage in corrupt practices can reap significant gains. However, they do so 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 politicians are at least partially accountable at election time (provided elections are contestable events), bureaucrats are often wholly unaccountable. This asymmetry needs to be addressed.

There is also a hierarchy of administrative levels typically associated with different corrupt transactions. In the case of fiscal incentives, for example, relatively high level officials and politicians are more likely to be involved in corrupt practices. On the other hand, in the case of foreign trade taxes, and routine activities, lower level officials are also likely to be involved, and they may share their illegal gains with those higher-up in the chain of authority. It is the routine cases of lower-level corrupt tax practices that often ultimately erode public confidence in governmental institutions. For this reason, these lower-level practices are often seen as more corrosive than abuses of power at higher levels. However, the damage done by subtle, often complex and hidden abuses of power should not be underestimated. [And ultimately the distinction may not be relevant as high-level and low-level corruption tend to coexist and reinforce each other?] (Please add the last sentence in Green without the question mark. thanks.)

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 on the other hand, are strongly manifested Corrupt tax practices often take place within a larger framework of comprehensive mismanagement in the public sector tax bodies: an absence of coherent tax policy, inadequate and imprecise legislation and regulations, confused lines of responsibility, lack of information, and professional

incompetence and misconduct. (Many tax policy experts therefore regard a healthy tax administration (system?) as essential for determining tax policy in many low-income countries. [?? Many tax policy experts therefore regard the tax administration as a key factor for determining the effectiveness of tax policy in many low-income countries??])

For the words in () above, please substitute the following:

Many tax policy experts regard the outcome or effectiveness of tax policies as primarily dependent on tax administration rather than on tax policy design itself. They therefore emphasize the need for tax design to be in line with the feasible level of efficiency in tax administration, and not overly rely on theoretically desirable tax design.

Designing Tax Systems to Minimize Corrupt Practices

It is evident from the discussion in the previous sections that the issues surrounding corrupt tax practices are complex, and not amenable to quick or easy solutions. Not surprisingly, one-off measures such as the granting of tax amnesties⁷, or the withdrawal from circulation of large denomination currency notes, 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 outcome of these efforts have also, at best, been mixed. It has become increasingly understood that without the imposition of fundamental complementary changes, tax reforms in and of themselves do not have a 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 officials, 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 of Africa, Asia, and Latin America”. (1988, 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 no prior or easy answer. As noted earlier, globalization has increased the urgency for such fundamental changes, but it is the internal dynamics of each society that will determine whether the needed changes will be made.

Measures to reduce corrupt practices are needed on a variety of fronts, and they need to be applied on an on-going basis over a long period of time. (The World Bank, 1997, p. 105). It is essential that as with tax reform, addressing corrupt tax practices come to be regarded as an on-going process and not as a one-off 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 the existence of a robust tax system and entrenched practices. Thus, strategies that address difficulties embedded in the political economy of the country, and that address economic literacy and political and leadership skill deficits (delete the question mark) in particular, 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 the relations between the state, taxpayers and tax officials are contemplated when shifting from a centrally planned economy to a market economy. In the transition economies, ensuring that government officials and others do not misappropriate state assets is also a hugely challenging task because of the unclear nature of property rights and enforcement problems (Tanzi and Davoodi, 2001).

In any explanation of the phenomenon of corruption, in general, as well as in the specific case of corrupt tax practices, the principal-agent model (or agency theory) is frequently used (Jain, 1998; Rose-Ackerman, 1999). The principal is usually a person or organization on whose behalf the agent undertakes various tasks. To avoid corruption, the key then 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 simultaneously reducing the opportunities for corruption, and strengthening the mechanisms for monitoring and punishment (The World Bank, 1997, pp. 105-107).

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

- Clarifying and streamlining laws and procedures in order to reduce official discretion. In many developing countries, laws dating back to colonial times have not been updated and changed in line with modern needs. Indeed, it is essential to reform the overall tax design and introduce new tax statutes simultaneously.
- Ensuring that tax rates are realistic in relation to trade and profit margins, and in relation to asset values.
- Avoiding attempts to overly fine-tune either the rate of taxation or the base structure of a tax to achieve presumed equity impacts. In practice, such fine-tuning adds an element of uncertainty and imprecision, and creates opportunities for corruption. The temptation to create overly complex tax structures (overwrought tax rates delete these words) should be avoided particularly in the case of income, sales, and excise taxes.[??] Delete ??
- Making greater use of withholding provisions, particularly for capital income. This measure could be combined with a gradual shift towards a system of self-

assessment of taxes. But to succeed, such a system would need to be backed by a tax office or administration with enhanced auditing capabilities.

- Making tax rules and regulations more transparent. In the case of taxes (and charges) simple measures such as posting the various charges (including form fees) prominently, disallowing the use of any receipts other than machine-printed receipts, and using IT to disseminate forms and information could help minimize information asymmetry and reduce the discretionary power of low-level bureaucrats. A tax guide not only written in the local language, but in simple and plain language that a layman can easily understand, could also help taxpayers to negotiate daily routines. The guide should include a code of conduct for tax officials and politicians in charge of the Ministries with revenue generating responsibilities. The central authorities would also need to fight illegal local levies, or illegal payments at lower levels (Gilley, 2001).
- Using IT for E-governance. Many countries around the world, in all income levels, are now attempting to use IT for E-governance. Among the high-income countries, Singapore, the United Kingdom, Chile, and the United States, have made significant strides in E-governance (Dass, 2000). In the United States, there are several private sector run sites that assist in E-governance. For example, a site called www.govworks.com collects local taxes, fines, and utility bills for 3600 municipalities across the country. Among the low-income countries, India (and the states of Andhra Pradesh, Tamil Nadu, Maharashtra, and Madhya Pradesh), (no brackets for Pradesh—it is a word in itself meaning state) in particular) 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 the delivery of government services; reduce transaction costs; and increase transparency (Dass, 2000). These in turn will reduce the opportunity to engage in corrupt tax and other practices, and bring down the price of bribery. This suggests that low-income countries with certain [technical and administrative?] Yes. Add technical and administrative. Delete?) capabilities, and the requisite political commitment and determination can use E-governance to significantly minimize corrupt practices. Information is indeed tantamount to empowerment in tax administration and compliance, but access to it should be symmetric rather than asymmetric.
- Improving transparency and accountability in budget preparation, execution, and oversight in governmental organizations and public enterprises. [are you talking here about the budgets of the tax office only? Or about the budgets of public sector institutions in general? Link this point with the point below?] (It is evident now) Note: this and the point immediately below are related but separate points.
- Adopting administrative reforms that introduce some competitive pressures in the workings of government departments and enterprises. These reforms should also provide the decision makers (delete management)management and the public with the appropriate information needed to assess performance and service quality.

- Devising a scheme to give due recognition to taxpayers, both individual and corporate, which maintain a good taxpaying record over a considerable period of time. Such schemes are already in operation in South Korea and India.
- Making payments for bribes non-deductible for both domestic and foreign businesses (OECD, 2000). Efforts to root out bribery, however, should not focus solely on the developing countries. A 1999 survey ranking the 19 leading exporting countries according to their propensity to pay bribes is a first step in the right direction in redressing the current imbalanced emphasis on bribe-making and bribe-taking in developing countries (<http://www.transparency.org.my/resource/bpi.html>). Interestingly, East Asia was well represented among the top ranks of this survey. China (including Hong Kong) was found to have the highest propensity, followed by South Korea, Taiwan, Italy, Malaysia and Japan. Such surveys need to be undertaken annually, and their scope needs to be widened. Moreover, the results need to be publicized more widely. The aim should be not only to bring more countries under the OECD Convention on Combating Bribery of Foreign Public Officials, but to find effective international mechanisms to deter such practices (OECD, 2000). In the 1999 survey, generally those countries that have ratified the OECD convention had a low propensity to pay bribes. However, South Korea and Japan were prominent exceptions. So mere ratification of the convention is clearly not a sufficient condition to deter such practices.

There are also various possible ways in which a country's mechanisms for monitoring tax practices and punishing corrupt practices could be strengthened. These include 9:

- Strengthening parliamentary oversight, and independent audit and investigative bodies.
- Using a tax ombudsman, as well as special tribunals and tax courts, to speed up the resolution of tax disputes.
- Reviewing the assignment of fiscal responsibilities and resources at various levels of government.
- Using credit-rating agencies, insurance companies, and others as indirect regulators and instruments for making available to a wider range of economic agents and the public information on government finances and tax practices. This

could be accomplished, for example, by developing a genuine market for state and municipal bonds, and by putting in place a competitive insurance sector.

- Adopting country and context specific methods to expand the number of taxpayers in the country. This is essential because if the number of taxpayers is well below its potential, then the burden on each taxpayer is likely to be well above the average. For these reasons, since 1988, India has implemented regulations (the so-called “one-in-six scheme”) under which an individual satisfying even one of six criteria must file an individual income tax return even if his income would appear to fall below the taxable threshold level. This has increased the number of individual income tax assesses from around 15 million in 1988 (yes fine) to around 25 million in the year 2001 (2000 not 2001). 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 the 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 underscores the need for developing databases on taxpayers from a variety of sources.

Multilateral institutions have considerable expertise in the technical aspects of the design and administration of tax systems. However, their advice needs to be measured against the requirements and needs of the specific local context in which the tax system operates (Rodrick, 1999). Further, it is essential that indigenous fiscal research and analysis capabilities be encouraged to enable the adaptation of external advice to local needs and contexts. Such capabilities are also important for ensuring appropriate lesson drawing.

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

It should, however, be recognized that tax systems and the extent of corrupt 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) behaviour need to be encouraged. Ultimately, the social and political ethos and values of a country cannot be separated from economic management issues in general and fiscal systems, including the tax system, in particular.

[[ANY CONCLUDING REMARKS??]] The last sentence of the above para is really the main message. So no additional remarks are necessary.

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Endnotes

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

2. The definition of a “tax” is far from straightforward, even if conventional taxes are considered. Taxes can, in general terms, be defined as a compulsory transfer of resources to the government from the rest of the economy. They may be levied in cash or in-kind (for example, through the exaction of mandatory labour) and they can be explicit or implicit. Implicit taxes arise, for example, when a government borrows household savings at rates below market prices, or returns to the public less than what it earns from investing these savings. 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 possess monopoly power. 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 article. The larger issues of corrupt practices in government expenditure management, and the urgent need to improve public expenditure efficiency also are not directly addressed in this paper. (See however, The World Bank, 2000, Chapter 5; Asher, 2001).

3. Thus, for the 1993-97 period, the tax revenue to GDP ratio averaged 17.1 percent, and accounted for about three-fourths of the total revenue in five Southeast Asian countries (namely, Indonesia, Malaysia, the Philippines, Singapore and Thailand). During this period, the share of total expenditures 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 a 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 100.00 as a project may have more than one objective.

5. A more vexing question is the share of responsibility in a corrupt tax (and government expenditure) practices in the countries with which the multilateral institutions have continuing lending programmes. The amounts involved are not small. 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 though the Bank was fully aware of its loans being misappropriated, it continued with its support of the lending programmes (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.

6. 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 tax revenue losses for the concerned governments. Unaccounted cross-border trade between India and Pakistan, for example is estimated to amount to US\$1 billion, several times the official trade figure (Joshi, 2001). This illegal trade is giving rise to a loss of significant revenue from import duties and other taxes to both countries at a time when these countries 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 a realistic level of import duties, would thus be beneficial to both countries.

7. Tax amenities may differ markedly in their results depending on whether they are perceived to be only one-time, intermittent, or permanent, as well as on whether they were anticipated by the taxpayer 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).

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

9. *Ibid.*

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