9

Corruption in Tax Administration

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Corruption has always been in existence, in one form or the other. As far back as the fourth century, B.C.E., Kautiliya, a Sanskirt scholar, wrote, "just as it is not possible not to taste honey (or poison) placed on the surface of the tongue, even so it is not possible for one dealing with the money of the king not to taste the money in however small a quantity. Just as fish moving inside water cannot be known when drinking water, even so officers appointed for carrying out works cannot be known when appropriating money" (Kangle 1972: 91). Kautiliya points out the ways in which employees can be involved in corruption and prescribes the modus operandi to be adopted by the king to deal with corruption and make appointments.

Broadly speaking, corruption can be classified into five categories: political corruption, administrative corruption, grand corruption, petty corruption, and patronage/paternalism and being a "team player." In this chapter the term is defined to include pecuniary or nonpecuniary considerations given to government officials for the use of public office for private gains.[1] Activities that lead to personal benefit that do not involve the government or a quid pro quo are not examined here.

The scope of this chapter is confined to corruption in tax administration. The chapter is divided into five sections. The first section focuses on the main causes of corruption in tax administration. The second section presents issues related to corruption in tax administration and analyses the role of procedures for administering custom duties, excise duties, and value added tax [VAT]). The third section reviews the impact of corruption on the economy. The fourth section suggests policy measures for combating corruption in tax administration. It highlights how the design of the tax structure and procedures of tax administration can reduce the risk of corruption. The last section summarizes the chapter's conclusions and recommendations.

Causes of Corruption in Tax Administration

A variety of factors contributes to corruption in tax administration (box 9.1). These include the complexity of tax laws and procedures, the monopoly power and degree of discretion of tax officials, lack of adequate monitoring and supervision, the commitment of political leadership, and the overall environment in the public sector.

Complexity of Tax Laws

The complexity of tax laws and procedures increases the magnitude of corruption in the tax system. Tax evasion is more likely to occur in a highly corrupt environment. Lack of requisite information makes taxpayers unaware of their rights and more exposed to discretionary treatment and exploitation.

BOX 9.1 Causes of Corruption in Tax Administration in Bulgaria

A survey in Bulgaria reveals that the main drivers of tax corruption are low pay, lack of professional ethics, legal loopholes, conflicts of interest, get-rich-quick ambitions, and bureaucratic red tape. The less satisfied tax officers are with their pay scales or with the fairness of career development and financial incentive schemes, the more inclined they are to engage in corrupt behavior. If their wages are comparable to the wages for a similar job in the private sector, they may not take the risk of engaging in corruption. However, if their wages are too low to support themselves and their dependents, the incentives for corruption rise. Tax officers' attitudes to corruption are also conditioned by the severity of the punishment for corrupt behavior and the likelihood of being punished when detected. Taxpayers do not play a significant factor in determining corrupt practices.

Source: Pashev 2005.

Monopoly Power and the Discretionary Power of Tax Officials

Tax officers are allotted a particular geographical area of operations. For a particular taxpayer, the tax officer is the tax department. This monopoly power gives tax officers the opportunity to entice taxpayers into corrupt practices by paying bribes.

Lack of clearly defined roles, functions, and duties of public officials create an environment ripe for abusive behavior (Pashev 2005). A high degree of discretionary power and the lack of adequate monitoring and reporting mechanisms are vital in providing opportunities for corruption. The greater the discretion, the greater the opportunity tax officials have to provide "favorable" interpretations of government rules and regulations to businesses in exchange for illegal payments.

Lack of Monitoring and Supervision

Because of asymmetrical information, it is difficult to monitor officers and hold them accountable for their actions. The absence of supervision and accountability gives workers an opportunity to refrain from performing public duties. Absence of measures designed to maintain the integrity of staff—such as the promotion and enforcement of ethical standards, merit-based recruitment and promotion procedures, and regular staff rotation schemes to prevent the creation of lucrative networks—increases the likelihood of staff indulging in corrupt practices.

Unwillingness of Taxpayers to Pay Taxes

In some developing countries, such as India, the extreme unwillingness of taxpayers to comply with the law—and hence their readiness to bribe tax collectors in order to reduce their tax liability—are important causes of corruption. Many taxpayers are willing to abet tax collectors if there is clear gain. This phenomenon is common in many middle-income countries.

Political Leadership

Political leadership sustains and often creates and protects corruption. Corrupt political leadership makes the spread of corruption at lower levels relatively easy. A hierarchy of administrative levels is 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. In the case of foreign trade taxes and other routine activities, lower-level officials are also likely to be involved, sharing their illegal gains with those higher up in the chain of authority. It is these routine cases of lower-level corrupt tax practices that ultimately erode public confidence in governmental institutions. For this reason, these practices are often seen as more corrosive than abuse of power at higher levels (Asher n.d.) As the power of a leader evolves into the political management of a service, the independence of officials is rapidly eroded by interference of political leaders, and the risk of corruption increases. Political appointments not only reduce work efficiency, they also facilitate corruption, as they did in Tanzania, where entrance into the police or the legal profession required joining the party (Sedigh and Muganda 1999).

Overall Government Environment

The level of corruption in tax administration generally parallels that in the administrative environment as a whole. Liberal economic systems offer fewer opportunities for corruption than socialist systems. The greater the administrative controls over the economy, the greater the problems of monitoring and accountability, because a greater share of economic planning decisions depend on bureaucrats.[2]

Administering Tax Policy

The objectives of a tax policy can be achieved only when the policy is properly administered. Most developing countries face various organizational and operational constraints to effective tax administration (box 9.2). In these countries, tax administration plays a crucial role in determining the real (or effective) tax system: tax administration is tax policy (Casanegra de Jantscher 1990). Failure to properly administer the tax therefore defeats its purpose and threatens the canon of equity. It allows the government to collect taxes only from easy to tax sectors and people who cannot avoid paying.

According to the business process model, the main factor causing corruption in tax administration is procedures. The greater the procedural interaction with the taxpayer, the greater the possibility of corruption.

Customs Duty

Corruption in customs administration is a major problem in many developing countries. Case studies of Mali and Senegal, for example, indicate that

BOX 9.2 The Nature of Tax Fraud in India

An empirical study based on field work conducted in 1994–95 indicates that tax evasion in India occurs partly through collusion between taxpayers and tax officers. Of 5,840 offences detected, 87 percent were procedural. These offences included incomplete or insufficient documentation, inappropriate use of credit on capital goods, inadmissible deduction of inputs, taking of credit before the commencement of production, use of undeclared inputs, faulty interpretation of notification issued by the department, use of unregistered dealer's invoices, extension of credit on endorsed invoices, declaration of invoices with incorrect address, and submission of invoices that were not in the name of the unit.

"Substantial" violations accounted for 7 percent of total revenue loss. These violations included irregular use of deemed credit, extension of credit on exempted final products, rejected inputs sent back without reversal of credit, extension of credit on basic customs duty, misuse of the facility of "job work," excess credit taken, and the use of the CenVAT credit by small-scale units that had opted out of the system.

Fraudulent violations accounted for 6 percent of total revenue lost. These violations included extension of credit without producing the required documents, extension of credit on invoices without physical movement, duplicate extension credit on same invoice, extension of credit without payment of duty, and use of fraudulent documents. These violations show a deliberate attempt on part of the taxpayer to defraud the government.

Source: Shome, Mukhopadhyay, and Saleem 1997.

these countries have faced serious problems of customs fraud in recent years (Stasavage and Daubree 1998).

Customs administration in India has been reformed over time. Some problems remain, however. One relates to the valuation of cargo. Taxpayers are often harassed on the grounds that the valuation is not correct; on this pretext, goods are detained. Importers usually compromise on the assessment in order to free the goods from detention. The imported cargo of regular importers is allowed to pass through a green channel, but cargo of casual traders is subjected to a full check.

Domestic Trade Taxes

The system of domestic trade taxes in India is unique. Under India's constitution, the union government has the authority to impose a broad spectrum of excise duties on production or manufacture, while the states are assigned the power to levy sales tax on consumption.

As a result of this dichotomy of authority, India has adopted a dual (federal and state) VAT system. The federal VAT, known as CenVAT, has effectively replaced the system of union excise duty. CenVAT allows instant credit for taxes paid on inputs. Empirical studies of its impact show that it has reduced the transaction cost of business (NIPFP 1989).

[[**AU: add to references**]]

All Indian states except Uttar Pradesh have adopted the VAT, replacing their age-old sales tax system. Most of the procedures prescribed for sales tax administration continue under state VAT. Checkposts at the borders of each state continue to monitor the flow of goods into the state through the main arteries of interstate trade. The use of road permits for administering the tax also continues. Under this system, the importing dealer receives these permits from the tax department of the importing state and sends them to his counterpart in another state before importing the goods. The trucks bringing the specified goods into the state are expected to carry back these permits, for scrutiny and verification at the checkposts. One copy of the road permit is then sent to the checkpost to the concerned assessing officer. All imports are accounted for and therefore taxed.

Although these checkposts play an important role, the system does not work as effectively and smoothly as it was intended to. The checkposts interfere with the flow of trade and traffic within the state and harass to a large number of dealers, the majority of whom are not liable for tax. The procedures allow for many points of interaction between taxpayers and officials, some of which could be eliminated.

Impact of Corruption

Corruption drastically reduces tax revenues, forcing governments to find other avenues for financing government expenditure, including borrowing. Future fiscal flexibility is reduced, because servicing of debt has to be given priority over other expenditures. This creates a vicious circle endangering fiscal sustainability.

Corruption is particularly alarming because it breeds further corruption—"corruption may corrupt," as Andvig and Moene (1990). Collusion between corrupt taxpayers and corrupt tax officials puts honest taxpayers at a disadvantage, encouraging them to evade taxes. If they do not, their profit margins are low, especially for small businesses.[3]

The effect on tax officials is also important. Corrupt colleagues and friends weaken the will of honest officers and reduce the probability of being detected or losing one's reputation. As the number of corrupt tax collectors increases, the guilt feeling of indulging in wrongdoing decreases.

As Fjeldstad (2005) notes, when networks of corruption exist, firing some corrupt officials does not improve the situation, as the fired officials become consultants and add to the network.

Corruption affects the quality of governance. It makes officials make decisions that do not serve the public interest but promote the interests of corrupt individuals. Administrative efficiency is at a low level, because patronage and nepotism tend to encourage the recruitment of incompetent people.

Corruption adversely affects investment and growth (Mauro 1995). When growth is weak, the returns to entrepreneurship fall relative to those to rent seeking; the ensuing increase in the pace of rent-seeking activities further slows growth. Higher bribes imply declining profitability on productive investments relative to rent-seeking investments, crowding out productive investments. Innovators are particularly at the mercy of corrupt public officials, because new producers need government-supplied goods, such as permits and licenses, more than established producers (Muphy, Shleifer, and Vishny 1993).

Widespread corruption reduces both foreign and domestic investment, as investors look for locales in which there is less corruption, less red tape, simpler laws and procedures, and transparent administration, all of which provide greater opportunities to grow. Corruption leads to economic waste and inefficiency, because it adversely affects the optimal allocation of funds, productivity, and consumption. When public resources meant for setting up productivity-enhancing infrastructure are diverted to politicians' private consumption, growth falls.[4] Pervasive corruption can also result in refusal by the donor community to grant aid.[5]

The cost of corruption to the society (in terms of both tangible and intangible costs) is extremely high. Intangible costs include the loss of trust in democracy, in leaders, in institutions, and in fellow citizens. Tangible costs include the impact on trade and investments, administrative efficiency, good governance, and equality of citizens.

Corruption has the potential to undermine the political stability of a country, by provoking social unrest and civil war that can threaten macroeconomic stabilization. In Tanzania corruption contributed to political instability and increased ethnic tension when a leader, for his own political purpose, claimed that some wealthy businesspeople from Asia, in collaboration with African leaders, were transferring the country's wealth aboard and impoverishing ordinary Tanzanians (Sedigh and Muganda 1999). He also insisted that the government was selling the country to Arabs and Zanzibaris. His comments not only intensified racial tensions, which a number of politicians sought to exploit, they also caused enormous capital flight from Tanzania.

Combating Corruption in Tax Administration

Which policy measures need to be adopted to combat corruption in tax administration depends on the social environment and the attitude about corruption held in the society—the factors that account for the degree of corruption in a country. What is regarded as corrupt practice in one country may be regarded as part of a routine transaction in another country. Social norms may be such that allegiance to their ethnic or religious or group supersedes individuals' responsibility to act as a honest bureaucrats.

Each country has to evolve the measures best suited to its own local requirements. Some policies that could be adopted by all developing countries plagued with corruption are described below.

Rationalize the Design of Tax Laws

One of the most important policy prescriptions for curbing corruption is establishing a rational tax system with simplified tax laws. The number of tax rates should be as low as possible and the number of tax exemptions as small as possible (if they cannot be eliminated altogether). In addition, the tax system should be integrated, with different taxes levied by all tiers of government. For taxes on commodities and services, it is important to avoid end-use exemptions, a major source of corruption.

The design of the tax structure should be as broad based as possible. The goal should be to have as many taxpayers as possible in the tax net, depending on the administrative capability of the country. If the number of taxpayers is well below its potential, the burden on each taxpayer will be too heavy.

A survey in India revealed that 89 percent of potential income taxpayers did not file (Aggarwal 1991). To expand its tax base, India adopted the "one-in-six scheme," under which an individual satisfying one out of six criteria has to file an individual income tax return, irrespective of his or her level of income.[6] This measure significantly increased the number of individual income taxpayers.

Designate Corruption a National Crime

The problem of corruption needs to be addressed at both the national and international level. National political leaders must make a commitment to eradicate this menace. A holistic approach, including prevention and enforcement, will have much better chance of success than a simple focus on individuals. The problem of corruption needs to be checked at the international level as well. Particularly given the fact that multinational companies bribe officials of developing countries to procure orders and contracts, a coordinated approach by bilateral donors and international organizations is useful. An important step in this direction would be blacklisting by multinational organizations of multinational corporations that engage in corrupt practices to obtain international contracts and encourage corruption in developing countries.

Reduce Monopoly Power

Since the monopoly power of tax officials encourages them to indulge in wrongdoing, the first step in combating corruption has to be to curb the monopoly power of these officials. Two steps have to be taken. First, tax departments must be re-engineered in countries where all activities of administration and assessment are performed by the same unit. It would be useful to assign the role of administration and audit to different units, as many developed countries do.

Second, tax officials should not be assigned to particular jurisdictions. Random assignment would not only take away the opportunity of tax officer to misuse their monopoly powers, it would also free taxpayers from the clutches of tax officials. For the selection of cases for audit, a separate unit should look into all available information and apply principles of risk management. This would eliminate contact between tax officers and taxpayers, reducing opportunities for corruption.

Another way to reduce the monopoly power of tax officials is to give them competing jurisdictions. Since collusion among several officials is difficult, competition tends to reduce the level of bribes substantially. Competition in the provision of government services must also be accompanied by more intensive monitoring and auditing to prevent corruption.

Make Civil Servants Accountable and Salaries Competitive

The system of recruitment of officers should be streamlined and a competitive examination system introduced. In addition, training must make tax officials committed to achieving clearly identified objectives. It should be made clear to officials that they are fully responsible and accountable for their assigned duties.

Civil servants' salaries should be high enough to allow them to resist the temptation to use their office for private gain. The incentives for corruption are considerably greater where salaries do not allow civil servants to live above the poverty level.[7]

In many African countries, civil servants' salaries and conditions of service have continuously deteriorated over the years, in most cases failing to keep pace with inflation (Kpundeh 1992). In such circumstances, employees may look for other ways to generate additional income. Departments such as customs and VAT, which have large numbers of low-paid workers who are in direct contact with the public, are especially ripe for corrupt behavior. In precivil war Somalia, salaries were so low that officials had to hold more than one job. Such a situation encourages bureaucrats to fall prey to corrupt practices (Klitgaard 1988).

An attempt should be made to reduce the overall number of employees in the public sector.[8] It would also be useful to adopt an incentive-based wage policy for public officials, as Singapore and Hong Kong (China) have done (Mookerjee 1995). In Singapore salaries in the public sector are higher than those in the private sector, discouraging corruption (Mookerjee 1995). It is also important to adopt a broad range of human resources measures, including development of performance indicators and performance-based incentive and promotion schemes.

Restructure Tax Administration Agencies

Tax administrative agencies could be restructured functionally. The duties of various functionaries within the VAT department should be streamlined, with an eye to minimizing personal interactions with taxpayers (Purohit 2001a). Internal audits must also be strengthened. The selection of an audit must be based on risk assessment based on information from local offices, results of audits conducted in the past, and the results of the computer assessment of returns received in the department. It is equally important to establish a wing of auditors specially trained to examine the accounts of vendors. Checkposts must be abolished and enforcement strengthened.

Severely Punish Corrupt Officials

Punitive action against corrupt officials can have an important deterrent effect. The role of the media is important in publicizing punishment of corrupt officials. Pecuniary penalties for corrupt behavior should be harsh enough to discourage officials from engaging in wrongdoing.

In addition to pecuniary penalties, in some severe cases of corruption, tax evaders need to be publicly caned or imprisoned. Stringent laws for punishment of corrupt officials, along with the confiscation of property amassed through bribery, will help reduce corruption. Such laws must apply to domestic offenders and foreigners alike.

Use Information Technology to Combat Corruption

Many countries around the world, at all income levels, are attempting to use information technology to combat administrative corruption (box 9.3). The use of such technology reduces the discretionary power of local officials, cuts transaction costs, and increases transparency. Most important, it reduces the interaction between taxpayers and tax officials, thereby reducing the opportunity to engage in corrupt practices.

The use of information technology automates government actions and procedures, reducing delays and face-to-face contact. It builds transparency

BOX 9.3 Using Information Technology to Streamline Services and Reduce Corruption in India

The Indian state of Andhra Pradesh has used information technology to reduce corruption in several tax areas. The Computer-Aided Administration of Registration Department (CARD) replaces manual procedures that lacked transparency in property valuation and resulted in a flourishing business for brokers and middlemen, who exploited citizens buying or selling property. The CARD system replaces the manual services with computerized services and introduces several new services. It eliminates interaction with tax officers. It completes registration formalities within an hour, through electronic delivery of all registration services. It improves the quality of services offered by providing a computer interface between citizens and the government.

Eseva Kendra provides a one-stop venue for services of the state and central government departments and private businesses. It provides online transaction processing of various payments to government agencies and issues certificates needed by citizens and businesses. It connects citizens to departments and agencies such as the state VAT and other state taxes; the electricity, water, and telephone utilities; the passport office; municipal corporations; and the departments of transport, tourism, and health.

All of India's offices of commercial tax department, including checkposts, have been computerized. Databases contain details regarding registered dealers, which can be analyzed and used for investigating evasion of state VAT.

Land records have also been revolutionized by computer technology. Until recently, obtaining land record documents was difficult and almost always required the help of middlemen. With the digitization of land records, farmers can get now obtain land ownership certificates in 5–30 minutes from a Citizen Information Centre (CIC) at the Revenue Office. Computerization of this function has ensured transparency in the system and made the life of ordinary citizens easier. Farmers can now apply for mutation either at the CIC or over the Internet. They can also check the status of their request online and present documentary evidence to authorities if their request is not processed within the stipulated time period.

and trust by sharing information with the public and making them more aware of their rights and privileges. It encourages greater accountability by officials, as it creates disincentives for corruption by creating fear of exposure.

Before introducing information technology), it is important to have a completely integrated system of taxes. Data from tax returns of individuals and corporations should be collected from the time of registration, continuing up to the payment of tax and the processing of returns. Information from the mainframe and data warehouse should be used to select cases for audit. Results of investigations should also be recorded, and other agencies should provide all necessary information. Such a system should maintain very tight security and confidentiality, without which the information could be abused.

Set Up an Independent Anticorruption Organization

Many countries have set up anticorruption commissions (box 9.4). Some are constitutionally independent of the executive branch; others are set up by the executive branch to serve either in an advisory role or with the

BOX 9.4 Using an Independent Agency to Combat Corruption

The wide variety of anticorruption management structures suggests the diverse approaches for combating corruption in different countries. Hong Kong (China) established an Independent Commission against Corruption, which carries out investigative, preventive, and communications functions. It has enjoyed resounding success in fighting corruption: Hong Kong now ranks as one of the least corrupt jurisdictions in East Asia (www.transparency.org).

India and Singapore established bodies devoted entirely to investigating corrupt acts and preparing evidence for prosecution. These bodies have also been successful in reducing corruption (Vittal 2003; Heilbrunn 2004).

In New South Wales, commissions report to parliamentary committees; they are independent from the executive and judicial branches of state. These commissions have changed the norms of how business is conducted, preventing corruption from occurring (Heilbrunn 2004. The United States implemented a multiagency model that includes offices that are individually distinct but together form a web of agencies that fight corruption (Heilbrunn 2004).

[[**AU: add to references**]]

The success of such organizations has encouraged governments elsewhere (in Argentina, Bosnia-Herzegovina, Guinea, the Republic of Korea, and Mauritius, for example) to create similar organizations. Mounting evidence suggests, however, that commissions have not been successful in countries where low levels of political commitment, lack of articulation among branches of state, and severe budgetary constraints have prevented the establishment of large and expensive anticorruption commissions (Heilbrunn 2004).

authority to investigate and help prosecute public officials at all levels. Countries also use presidential commissions, multisectoral advisory groups, institutions to administer ethical codes of conduct, special authorities or commissions to handle or investigate specific corruption allegations, and other bodies.

Decentralize Government

Experience and theory suggest that an organization is most vulnerable to corruption when bureaucrats enjoy a monopoly over taxpayers and take actions that are difficult to monitor. The relation between the executive branch and other participants in government, such as the legislature, the judiciary, local jurisdictions, political parties, the media, the private sector, and nongovernmental organizations, needs to be broadly articulated.

Democratic systems offer a mechanism to minimize corruption by introducing greater accountability and transparency in governance. When local governments have some real power, they not only address local interest more authentically and confidentially, they also exercise a check on the operations of higher levels of authority. However, the effectiveness of decentralized service delivery depends on the design of decentralization and the institutional arrangement governing its implementation. An institutional environment should provide political, administrative, and financial authority to local governments, along with effective channels of local accountability and central purview.

Two key ingredients are needed for the potential gain to outweigh the costs. First, decentralization must involve real delegation of authority, including the authority to generate and reserve a portion of local revenues. Second, local authorities must themselves be accountable to higher levels and local groups. Abuse of authority and public corruption are less likely to occur if the rules governing local officials are at least in part defined by local norms (Charlick 1993).

Establish a Code of Ethics

At the national level, every country should have a comprehensive code of ethics that spells out appropriate and inappropriate behavior for politicians as well as bureaucrats. A leadership code of conduct is important, because the country's future prospects depend, to a very large extent, on the quality and honesty of its leaders. The leadership code should describe the expected and prohibited forms of conduct by government leaders (Kpundeh 1999; Ruzindanda and Sedigh 1999). It should outline a broad concept of what constitutes leadership, emphasize the role of leaders in setting an example, and identify principles of good leadership. It should include provisions that check the misuse of state property through annual disclosure of leaders' income, assets, and liabilities. At the same time, it should ban certain activities, such as seeking or accepting gifts or benefits relating to official duties and personal interests; abusing government property; and misusing official information not available to the public.

Provide Tax Officers with Ethics Training

Intensive training of officers in ethical conduct is of paramount importance, even in countries that lack good governance (Huther and Shah 2001). Course contents should include the laws and rules of the tax being administered and emphasize ethical values such as integrity, honesty, public service, justice, transparency, accountability, and the rule of law. Training should be repetitive in nature, followed up with refresher courses. Officers should be aware of existing anticorruption measures as well as their responsibilities and the liability involved.

A public ethics program can be carried out in several ways. Ethics management guidance can be offered by training tax officials. Ethics audit research and inquiry can be conducted to assess their strengths and weaknesses. The objective of ethics maintenance is to make the ethical gains of the agency sustainable. Assistance from anticorruption bodies, civil society organizations, and private firms can be used to sustain best practices as well as to improve and monitor the effectiveness of public ethics programs. Taxpayer education programs could be strengthened through interactive television and radio programs and pamphlets.

Inform Taxpayers of Their Rights

Access to accurate information should be a right that is publicized adequately so that taxpayers are aware of it. All tax rules, rates, and procedures should be available on the Internet. Lack of access to information about rules and regulations make taxpayers unaware of their rights and expose them to discretionary treatment by corrupt officers.

Conclusions and Policy Recommendations

An irrational tax structure, monopoly and discretionary power in the hands of government officials, a low degree of accountability or transparency in administration, and interference by political leadership are the main causes of corruption in tax administration. Low pay, the lack of severity of punishment for corrupt behavior, poor-quality service, and greater politicization of government also encourage corruption.

The desired objectives of tax policy can be achieved only when it is properly administered. In most developing countries, tax administration is tax policy. Failure to properly administer the tax, therefore, defeats its very purpose and threatens equity. Involved procedures cause deficiencies in tax operations, reduce overall tax collection, and cause corruption in tax administration.

When corruption becomes a way of life, it has far-reaching implications. It undercuts efficiency and equity, as well as the macroeconomic and institutional functions of government. It reduces revenue to government, endangering fiscal sustainability, and adversely effects investment and growth. The presence of corrupt officials encourages other officials to engage in corruption, because the probability of being detected or losing one's reputation declines. Likewise, the presence of corrupt taxpayers encourages other taxpayers to cheat.

Fighting corruption takes time. Power groups whose interests are threatened can scuttle efforts. But letting corruption fester can be even more dangerous. Which policy measures need to be adopted depends on the overall social environment and the attitude about corruption held by society.

One of the most important policy prescriptions for curbing corruption is creating a tax system that is rational, equitable, and simple. Reducing the monopoly and discretionary power of tax officials is also very important. The tax structure should be as broad as possible, in order to maximize equity. Bureaucrats should be given competing jurisdictions, so that competition among officers will drive the level of bribes to zero. Monitoring and auditing must be increased to prevent corruption. The system of recruitment of officers should be streamlined, and officers should be given intensive and repetitive training for promoting a code of conduct, with emphasis on ethical values, such as integrity, honesty, public service, justice, transparency, accountability, and rule of law. Salaries should be high enough that officials are able to support themselves and their dependents without accepting bribes. An anticorruption commission can be set up that maintains transparency in the system and makes political leaders and officers accountable for their actions. Decentralization can also help curb corruption. Its effectiveness depends on the design of decentralization and the institutional arrangements governing its implementation.

Notes

1. Corruption is, of course, prevalent in the private sector, too.
2. In Sierra Leone the All People's Congress, the only political party from 1978 to 1992, totally controlled civil servants' political views and associations. From the inception of the one-party system, neopatrimonial politics dictated that civil servants be party members. In return for their loyalty, civil servants were often shielded, pampered, and allowed to increase the range of their powers and pursue opportunities for self-enrichment (Kpundeh 1999).
3. A 1999 survey conducted by the European Bank for Reconstruction and Development of some 3,000 enterprises in 20 transition economies revealed that "bribes" (a category that includes corrupt tax practices) act like a regressive tax. The bribe paid by smaller firms amounted to 5 percent of their annual revenue; bribes paid by medium-size firms amounted to 4 percent of their annual revenue, while those paid by larger firms amounted to slightly less than 3 percent of their annual revenue. The study reveals that smaller firms paid bribes more frequently than medium-size or larger firms (Asher n.d).
4. The diversion of public resources, services, and assets to private use in Uganda resulted in deteriorating roads, poor medical facilities, dilapidated and ill-equipped schools, and falling educational standards (Ruzindana and Sedigh 1999).
5. The international donor community jointly suspended aid to Tanzania in 1994, largely in response to massive irregularities in the tax system. Donors declared that they would not resume assistance until the government took steps to collect evaded tax, recover exempted tax, and initiate legal proceedings against corrupt tax officials (Sedigh and Muganda 1999).
6. This scheme was introduced to identify potential taxpayers. It stipulated that a person having a credit card, owning a house, possessing a vehicle, paying an electricity bill of more than Rs. 50,000 a month, leaving the country during the year, or belong to a club is obligated to file an income tax return (Aggarwal 1991). The scheme was eliminated in 2006-07.
7. A more workable solution for making civil service salary competitive would be to focus on the performance-based component of gross pay, reflecting and rewarding each tax officer's contribution to the success of anticorruption policies and higher collection rates (Pashev 2005).
8. Uganda reduced the number of employees through a variety of measures. "Overdue leavers" (workers past retirement age, irregular entrants, and those identified through performance assessment as incompetent) and "ghost workers" (deceased workers, fictitious workers, or former employees who remained on the government payroll) were identified and eliminated. The "group employees' scheme," which allowed senior managers to recruit their own casual, short-term workers without reference to established job grades, was abolished. Surplus workers who were competent, bona fide workers but could not be deployed elsewhere in the government received severance packages. These measures helped Uganda replace a large number of public sector employees with a smaller number of higher-quality staff.

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