



REVENUE ADMINISTRATION AND CORRUPTION: WHAT WORKS?

How can corruption effectively be overcome in revenue administration in developing countries? What are the appropriate measures and effective responses? What could and should donors do?

Fighting corruption in revenue administrations requires reformers to look beyond the formal structures of the central state, to the informal networks of patronage and social domination which often determine how political power is actually wielded in poor countries. This CMIBrief elaborates on appropriate measures and effective responses.

POLITICAL WILL AND AND WELL-PLACED TOP MANAGEMENT

Tax administrative reforms are political processes that will pose a threat to important domestic stakeholders. They take time to achieve and are often contested. The successful implementation of such reforms requires political will and support from the highest level of government. Tax administrative reforms are unlikely to succeed if the main source of energy and leadership comes from the outside. Donors cannot play a leading role nor dictate the content, pace, and direction of administrative reforms.

A strong and well-placed leadership of the revenue administration is essential for overcoming political and bureaucratic obstacles. This applies both to revenue departments located within the Ministry of Finance and to semi-autonomous revenue authorities.

INDEPENDENCY IMPORTANT

Based on experiences from across the developing world, this often requires a better demarcation of management authority between the top manager of the revenue administration(s) and the Ministry of Finance.

The revenue administration possesses unique datasets on taxpayers and revenue bases. This information is essential for improving tax policy and legislation. The role of the Ministry to formulate and design tax policy, and the responsibility of the revenue administration to implement this policy, must be unambiguous and mutually respected. A Minister of Finance acting as the chief executive involved in day-to-day operations, undermines a strong and effective daily leadership of the revenue administration.

CAPACITY BUILDING FOR TAX POLICY-MAKING IN THE MINISTRY OF FINANCE

Providing timely and well-argued policy advice to the revenue administration is regarded as a core responsibility of the Ministry of Finance. The MoF's capacity to fulfil this function is in short supply in many developing countries, a problem that has been under-addressed by donors involved in tax administrative reforms. In particular, there is a need to strengthen the capacity for assessing revenue potentials and realistic budgeting. Recent experiences from South Africa and Tanzania are promising in this respect.

ADDRESSING PATRONAGE

Norms, as reflected in patronage and social obligations, are liable to discourage the development of a professional tax administration. Breaking the influence of kin-based networks on the operations of the revenue administration is essential to succeed.

It is difficult to insulate the revenue administration from contexts in which graft and corruption are normal in public sector operations. We know that similar conditions were widespread in Western societies before modern public finance management took root. Observations of contemporary African societies also suggest that the impact of traditional values and social obligations on the behaviour of public officials, have fluctuated and can be changed. There are revenue administrations in Africa that perform relatively well despite dauntingly unfavourable contexts and an overall poor public sector performance.

Experiences with the Zambia Revenue Authority, for instance, show that expatriate senior advisors and top managers, who are in place for a pre-defined and limited period of time, can contribute to effective change by building integrity and professionalism in the organisation through systemic changes. Placing expatriates in key management positions might also help to avoid the unfolding logic of patronage and predatory authority. Strong expatriate leadership may more easily confront political and bureaucratic pressures, and provide a 'buffer zone' within which systemic changes and new forms of staff behaviour can be established.

PRIVATE MANAGEMENT AND OUTSOURCING OF REVENUE COLLECTION

Private management of tax administration is raised as a possible approach, but such reforms have achieved few lasting results. The transfer of skills by foreign contractors has been limited and such contracts have been very expensive for the government. Tax practitioners are therefore increasingly questioning the value of outsourcing tax administration.

In Customs, for instance, outsourcing other activities such as valuation and entry processing is risky, since it places the collection of government revenue directly into the hands of non-government interests. In countries with a high level of corruption, there is no reason to believe that those interests will be any less corrupt. Placing private customs personnel in line jobs in operational units may compound the current failure to manage and, thus, entrench the problems. Instead it might be a better approach to upgrade the revenue administration's own capacity to carry out these tasks.

ORGANISATIONAL CULTURE AND LEADERSHIP STYLE

Public institutions with a culture that is outcome-oriented and 'mission-driven' appear to have higher levels of performance than organisations lacking these features. This underscores the importance of leadership styles and internal performance management practices that focus on results and services to the public. In tax administration an appropriate system for setting performance objectives and measuring progress against them need to be developed.

Encouraging the development of a positive organisational culture may be an important way of improving the performance of a



revenue administration. Internal leadership and culture are likely to play a key role in establishing merit and performance-oriented organisational behaviour in situations where formal political and administrative institutions are weak.

HUMAN RESOURCES MANAGEMENT

Many tax administrations are top-down organisations characterised by submissiveness. Promotion is in general based on seniority. Younger staff members are given few opportunities to develop their skills. Incentives are in general weak in the sense that good performance is not rewarded and bad performance is not punished. Required measures would include a rigorous re-staffing process, also at the senior management level, and the introduction of human resources policies like transparent recruitment procedures, adequate remuneration, pension/retirement schemes, etc.

A reformed recruitment and advancement mechanism conducive to attracting, retaining and motivating highly qualified staff is essential. Improved salaries, retirement benefits and physical working conditions ought also to be part of the modernisation programme.

Such measures should take place before proceeding with traditional forms of technical assistance such as the design and implementation of integrated computer systems, organisation of formal training courses and on-the-job training, and process re-engineering in a wide range of areas, including better forms, filing, auditing, revenue management, taxpayer education programs, and so on.

STAFF REMUNERATION

Remuneration should take into account the sometimes dangerous and difficult working conditions and hardships faced by revenue officials. This is particularly the case for customs officials engaged in audit or enforcement activities where discretionary powers are significant and the environment is not conducive to effective supervision and accountability.

In many former socialist countries, border police officers are paid substantially better than customs officials who perform relatively similar duties. Such practices are perceived to be unfair and may demoralise the customs staff. Penalties applied to breaches of a code of conduct are more likely to be accepted in circumstances where the difficult working environment and required levels of integrity are recognised in the base level of remuneration. Anti-corruption programmes that fail to address this issue are therefore likely to fail.

INTERNAL AUDITS AND MONITORING

The degree of audit intensity may determine the effectiveness of the wage level as an anti-corruption tool. Recent research has found the effects of higher wages on corruption - when audit levels are low and corruption high - to be zero, while they are negative when audit and corruption levels are intermediate. In settings where the auditing intensity is high and the corruption level is low, the effects of higher wages on corruption is found to be positive but low. These results imply that wage incentives should be linked to and not isolated from other measures. Positive incentives should be complemented by negative incentives. 'Carrots and sticks' should be viewed as complementary tools in the fight against corruption. This dual strategy is also recommended in anti-corruption strategies developed by the World Bank and the World Customs Organization.

BUILDING TAXPAYING CULTURE

In many developing countries the tax system is regarded as illegitimate by large numbers of taxpayers and citizens. Business communities, taxpayers' associations, trade unions and other influential domestic institutions have a critically important role to play in pressuring the revenue administration to do a better job of serving the society.

Some observers conclude that a lack of a taxpaying 'culture' is the largest obstacle to building a firm long-term revenue base

in poor countries. The opposite may be the case: as long as the tax administration culture is perceived to be influenced by sectarianism, nepotism, and corruption - it will not foster a more conducive taxpaying culture. Despite quite comprehensive changes in the tax structure (rates and bases) in recent years, the tax systems in many developing countries are still complicated and non-transparent. Tax legislation is unclear and causes random and partly ad hoc collection procedures. Assessors often have wide discretionary powers to interpret tax laws - for instance to allow or disallow expenses or charges, or to exempt items from import duties. These factors, combined with a perception of limited tangible benefits in return for taxes paid, legitimate tax evasion.

Reforms of tax legislation and collection procedures, including measures to improve accountability (see below), and transparency (see below) in the taxpayer-tax officer relations, should take place concurrently to reduce opportunities for corruption and the demand for corrupt services.

BUILDING ACCOUNTABILITY

A strong bond of accountability between citizens (taxpayers) and the public sector may contribute to generate demand for tax administrative reforms. Tax administration performances are partly determined by the interplay between the public sector and the country's key institutions of accountability: the legislature, the judiciary, the auditor general's office, the media, and organised civic groups such as major business communities, taxpayers' associations, and trade unions. For taxation to have a positive effect on accountability between government and taxpayers, taxation

must be 'felt' by a majority of citizens. Then it will trigger a demand for greater accountability and improved public service delivery.

Recent tax reforms in many developing countries have not done much to widen the tax base. In Peru, for instance, less than 1% of the taxpayers pay more than 85% of the taxes. It has proven especially difficult to incorporate informal business operators and professionals, such as lawyers, doctors, and private consultants, into the revenue base. Formal business corporations seem to be the only visibly affected by central government tax reforms. Tolerance of wide spread informal sector non-compliance, lowers the fairness and the effectiveness of the tax system. Still there are indications that an organised voice and response to revenue policies is developing within the business and trading communities in some countries, including Tanzania and Mozambique. The fact that some tax issues are being treated through formal, public organisations, rather than through bribery and public deals may indicate the beginning of a link between economic elites and government in issues of revenue generation.

Successful tax administrative reforms should address shortcomings in the accountability environment within which the revenue administration operates. Reformers must have an appreciation of factors such as key accountability institutions' access to information about revenue collection (what has been collected from whom, where and at what costs), and capacity to analyse tax information in order to place demands for better performance. Wide dissemination of information that allows citizens to monitor revenue collection and public expenditures



may have a powerful and positive impact on the attitudes and behaviour of both tax officers and taxpayers. The South African Revenue Services, has used the media to highlight success and “name and shame” tax evaders. This has resulted in a raising of the stakes and a shifting of incentives for non-compliance.

TRANSPARENCY

Transparency is a key issue for all revenue administrations. Increased accountability and an open and honest relationship with taxpayers are crucial for maintaining public trust and confidence in the performance of tax administration. Taxpayers must be able to expect a high degree of certainty in their dealings with revenue agencies. This can only be achieved when tax laws, regulations, procedures, and administrative guidelines are made public, easily accessible, and applied in a consistent manner. Any deviations from laws, regulations, and discretionary power should be justified and documented for later review.

The experience of the Zambia Revenue Authority (ZRA) provides a practical example of what a commitment to increased levels of integrity can achieve. The ZRA has introduced a number of positive initiatives designed to increase taxpayers’ awareness of tax laws, customs rules, and regulations. These include publication of information brochures and posters, development of a public website, and regular participation in public radio programs. In Morocco, the customs website contains the essential rules and regulations governing customs operations, as well as data on international trade and various performance indicators, including detailed and regularly updated clearance times.

The Peru customs website posts information on customs rules and regulations, and all its activities and programmes. In Turkey, legislative arrangements are updated on customs’ official website, and traders are provided with guidance on the formal procedures to be used for seeking advanced rulings on tariff and valuation. Internal transparency standards can be enhanced by maintaining a tracking and analysis system for complaints, ensuring that any complaints are examined and dealt with promptly (see World Customs Handbook at www.worldbank.org).

DONORS: PREACHING TAX MORALS BUT PRACTICING TAX AVOIDANCE

Tax exemptions on transactions by foreign development assistance and on donor funded imports have distorting effects. In addition to exemptions granted to donor agencies, these exemptions often include foreign companies engaged by the donors (e.g. construction companies). This has contributed to eroding tax bases not only for import duties, but also for corporate and personal income taxes and taxes on domestic transactions. Governments receiving foreign aid should impose tax on imports of goods and services to bilaterally and multilaterally funded projects.

At least two African countries (Senegal and Togo) took steps in the 1990s to eliminate tax exemptions related to bilateral and multilateral assistance by fully taxing capital imports financed from abroad, and crediting donor accounts for the taxes paid. While these procedures do not directly add any revenue to the budget, they represent a system of control that may reduce fraud, and thereby contribute to raise government revenues. It may improve both budgetary transparency and resource allocation by fully accounting for public investment costs. It may also contribute to a more fair competition between local and foreign companies competing for donor contracts.

IN CONCLUSION: REFORMS TAKE TIME

Evidence from both Western and low-income countries appear to favour an incremental approach to reform. Public management reforms in developed countries (except New Zealand) succeeded to a large extent because they were much more incremental than is commonly supposed. Over-ambition is cited as a common cause of failure in various countries. This does, however, not imply that governments in poor countries should keep the scope of tax administrative reform limited. When governments decide what measures to take in their reform programmes, they should bear in mind the state of the economy and the resources at hand. In general, most poor countries have neither the political capital nor the administrative capacity to sustain more than a limited range of concurrent initiatives. An incremental process of change can add up to a radical transformation if it is sustained long enough. Unfortunately, experiences from aid dependent countries indicate that too comprehensive reform programmes are initiated to attract aid money.

Perhaps the most easily overlooked lesson about reforms of revenue systems is that it takes time to achieve fundamental reform of a public institution. It took centuries for today’s industrialised countries to develop reasonably effective tax administrations. Poor countries in Africa, Asia and Latin America attempt to achieve this in a couple of decades. It is therefore not surprising that the record to date has been full of failures and disappointments. Sustainable change demands sustained effort, commitment and leadership over a long time. Mistakes and setbacks are a normal and inevitable part of the process. The big challenge is to use failures as learning opportunities, rather than as excuses for abolishing reforms.