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THE ADMINISTRATIVE DIMENSION OF TAX REFORM IN DEVELOPING COUNTRIES (*)

The importance of good administration has long been as obvious to those concerned with taxation in developing countries as has its absence. Over thirty years ago, Stanley Surrey (1958, pp.158-59) noted that "the concentration on tax policy - on the choice of taxes - may lead to insufficient consideration of the aspect of tax administration. In short, there may well be too much preoccupation with 'what to do' and too little attention to 'how to do it'" (1). Although Surrey's paper has been frequently cited, and presumably read, there is surprisingly little evidence in the hundreds of articles, books, and reports on tax reform written over the last few decades that this warning has been taken sufficiently seriously (2). It thus seems time to sound the alarm again, before we launch into another thirty years of misguided attempts to reform tax structure while largely ignoring tax administration (3).

The basic message of this paper is that the administrative dimension should be placed at the centre rather than the periphery of tax reform efforts. The topic is first introduced in the next section in the context of a brief case study of Papua New Guinea. The argument is that the tax system with which Papua New Guinea was launched into the world a decade ago is completely unsuited to both its economic structure and its administrative capabilities, and needs to be drastically reformed in recognition of the probable persistence of these constraints.

Although in many ways Papua New Guinea is a unique country, this problem is by no means unique to it, as the remainder of the paper sets out in detail. The overwhelming importance of the administrative dimension in developing countries is first stressed: as Casanegra (1987, p.25) put it, "...tax administration _is_ tax policy." Some solutions that have been proposed to the pervasive malaise characterizing developing country tax adminstrations are next reviewed and, for the most part, found wanting (4). It is argued that the most rewarding approach to tax reform in most countries is likely to be, as in Papua New Guinea, to design a tax system that can be acceptably implemented by the existing weak administration. Miracles being always in short supply, any other course of action is, in the end, unlikely to prove successful.

Tax Reform in Papua New Guinea: Backward to the Future

The range and variety of conditions found in developing countries is so great that lessons derived from the experience of any one country may be applied to others only with considerable care. In some ways, Papua New Guinea is so different from any other developing country that this warning seems particularly appropriate: what other country of less than 3 million people has over 700 languages, a population which ranges from stone-age farmers to sophisticated western businessmen, a functioning democracy, and 22 partly autonomous provincial governments? In other ways, however, Papua New Guinea's experience seem close to that of many African countries in the post-colonial era (Wedderspoon, 1969). In particular, Papua New Guinea illustrates the often unhappy consequences of implementing in one country the ideas currently fashionable in another, without paying adequate attention to the vast differences in the economic and administrative situations of the two.

Indeed, the misfit between the relatively "advanced" tax (and expenditure) structure Papua New Guinea inherited at the time of achieving its independence from Australia in 1975 and its economic and administrative realities is so great that the only sensible direction for future tax reform appears to be, so to speak, to go backward in time and to introduce some of the sorts of crude, but workable, devices that may function better in such an environment (5). Experience elsewhere with respect to collecting taxes with very limited administrative resources in a highly fragmented, largely illiterate, poorly developed rural economy would seem to provide a more relevant basis for the development of a workable tax structure in Papua New Guinea than the latest fad in the developed world - whether it be the highly progressive income tax of the 1960s or the flat-rate tax of the current era.

Like all developing countries, Papua New Guinea faces increasing budgetary demands simply to provide services to its rapidly expanding population. In addition, the Australian government has recently announced that the level of its foreign aid, which currently finances one-third or more of Papua New Guinea's total budgetary expenditures, may well be decreased in the next few years. There is thus no alternative to strengthening the national revenue system if the current level of government expenditures is to be maintained, let alone improved and extended (6).

The Changing Structure of Taxation

Many of the reports written on how to deal with this problem have urged increased use of indirect taxes, especially those on imports (Lent, 1976; Mathews, 1980; Collins, 1985). An income tax cut and tariff reform introduced in 1987 (Chan, 1986) in fact went some distance in this direction. As Table 1 shows, in 1952 most of Papua New Guinea's (much smaller) revenues did in fact come from taxes on foreign trade. At that time, the fiscal structure basically matched the very underdeveloped nature of the economy. By 1961, following the introduction of an income tax and the abolition of the export tax, the relative importance of trade taxes declined. As late as 1971, however, the revenue structure remained more or less as one might expect to find it in a largely underdeveloped, rural, fragmented, and dependent country: relatively high dependence on import duties, traditional excises and stamp duties, with the balance coming from income taxes paid almost exclusively by a small enclave of expatriate companies and employees.

By the time of independence in 1975, there had been a startling change in this situation. Although almost half the company taxes collected in that year came from Bougainville Copper (BCL), the effects on revenues of very substantial increases in both company and personal income tax rates are also apparent in Table 1. Although income taxes did not long retain this prominence in the total revenue picture, their decline over the subsequent decade is almost entirely attributable to the fall in revenues from BCL. Indeed, personal income taxes not only retained but increased their importance, as did both excises and customs duties, the latter largely as a result of the growth of imports relative to GDP. On the other hand, the growth of personal income taxes was entirely attributable to increased effective tax rates, owing to the highly visible interaction of increased nominal incomes and the progressive rate schedule (Thac and Lim, 1984; Lim, 1987).

The result has been considerable unrest in recent years in the ranks of the relatively small band of income taxpayers, especially the politically important, though numerically very small, group of national (in contrast to expatriate) taxpayers. Nevertheless, the extent to which there has been a substantial shift towards increased reliance on indirect, and particularly import, taxes since independence is striking. Despite the narrowness of the indirect tax base in the largely rural economy of Papua New Guinea (7), the desired move to greater reliance on indirect taxes is thus already a reality. Nonetheless, the prospects for direct taxation are so bleak that still further moves in this direction seem necessary.

Revising the Present System

Personal income tax. Personal income tax revenues are dominated by the proceeds of the fortnightly tax on wages and salaries. Introduced in 1980 largely to relieve the processing burden on a tax administration creaking under the strain of losing almost all its experienced (expatriate) officials, this tax accounted for almost 95 percent of all personal income taxes collected in 1985. Indeed, since 1981 the amount of income taxes collected from individuals other than by wage withholding has actually declined, even in nominal terms! The efficacy of the income tax in reaching such recipients of nonwage income as landlords, small businessmen, and self-employed farmers and professionals is low, and decreasing.

Similar administrative deterioration is apparent in increasing arrears figures with respect to both personal and company income taxes. These poor results, in the face of a substantial increase in the numbers of staff in the tax office (from 108 in 1980 to 213 in 1985), a sharp fall in the number of returns with which they have to deal (8), and a consequent drastic reduction in the number of assessments issued per tax official (from over 900 in 1980 to less than 90 in 1985), do not appear to augur well for the future of the personal income tax in Papua New Guinea (9).

Even more importantly from a revenue point of view, the base of the wage tax is shrinking. 'In 1986, some 55 percent of wage taxes were paid by expatriate employees, who constituted less than 9 percent of the taxpaying population (10). At the time of independence in 1975/76, the corresponding proportions were 82 percent of taxes and 16 percent of taxpayers. When this decline is combined with the rapid increase in personal income tax revenues over the last decade (Table 1), it appears that Papua New Guinea has managed to triple the amount of income tax collected from national taxpayers over the course of a decade of very slow real income growth (and almost no inflation). The political resistance to which this rate of expansion has given rise virtually ensures that it will not be.

Personal income tax revenues thus remain precariously dependent on the base provided by a small, and declining, expatriate population. In 1986, for instance, the average tax rate on expatriate taxpayers was 28 percent, compared to 9 percent on national taxpayers. Should localization proceed more rapidly at the higher levels - an important political objective - and the salaries at these levels become more realistic in local terms - an economic necessity - or should events induce an even faster outflow of expatriates than is already taking place, the income tax base will evaporate even more quickly. The prospects for expanded personal income tax revenues in the future in the face of a shrinking expatriate base, increasing taxpayer resistance by nationals, and apparently deteriorating administrative capacity, are thus bleak.

In addition, the prevailing wage structure also has important implications for income tax reform, which do not seem to have always been appreciated. One recent report, for example, recommended the introduction of a flat-rate tax as a simpler, equally equitable, and more efficient means of raising around the same revenues from the personal income tax (Collins, 1985). Many good things can obviously be said in support of this proposal, not least on administrative grounds. If the same revenues are to obtained from the income tax, however, moving to a flat rate in Papua New Guinea would imply a substantial increase in taxes on nationals and a reduction in taxes on expatriates - a combination with no apparent economic benefit and obvious political problems. No doubt the 1200 expatriates and 200 nationals affected by the reduction of the top marginal rate in 1987 were duly grateful, but absolutely nothing seems likely to have been gained in terms of equity, efficiency or even administrative simplicity as a result of giving up this revenue.

Import duties. In the end, if any new revenues are to be squeezed from the existing tax system, the only real possibility appears to be through increased taxes on imports. Increasing the basic tariff rate (which is applicable to all imports except for a very few "basic" consumption items) from the present 7.5 percent to 10 percent or more is probably the simplest and most acceptable way to increase revenues quickly. The tariff increase implemented in 1987 will thus in all likelihood be followed by others in the near future. One problem with this scenario of course is that Papua New Guinea may begin to tread the slippery path of import-substitution in a way it has so far largely managed to avoid (11). On the whole, however, there is little alternative to higher import taxes if more revenue is to be obtained from the existing tax structure in the near future. The revenue structure by 1991 may thus look more like that in 1971 than that in 1981 (see Table 1).

Matching Tax Structure to Economic Structure

Such increased reliance on import taxation clearly represents a step backward in the "normal" evolution of fiscal structures in developing countries. If Papua New Guinea is to levy any effective taxes on the growing "informal" sector of urban traders or rural smallholders, however, it will almost certainly have to go even further back in developmental time.

Taxing the "informal" sector. The only practical way to extract significant revenues - or, indeed, in many instances any revenues at all - from the growing urban national small business sector of traders, microbus (PMV) owners, landlords and the like is through the introduction of some form of "presumptive" taxation based on hard-to-conceal external indicators of activity (Nield, 1980; Chelliah, 1981; Bird, 1983). To date, there has been only one limited experiment along these lines in

Papua New Guinea, with respect to PMV-owners - and this effort was aborted in 1986 as soon as it showed any sign of being effective. Political support for still more efforts in this direction seems unlikely.

Moreover, although an ambitious program of assistance to the tax administration is currently under way with the aid of the Australian government, those involved do not seem particularly aware either of the problems of taxing the urban informal sector or of the sorts of approximate solutions developed in other countries. Further refinement and more assiduous application of techniques to track down revenues in the small, organized, sector that keeps accounting records, as is mainly envisaged in the current plans, while obviously useful, will not help in the basic tasks of identifying, assessing, and enforcing tax in the informal sector (12).

Even if a major effort were launched to reach these hard-to-tax groups, little revenue can realistically be expected from this source. Nevertheless, unless the income tax is to be converted irredeemably into a discriminatory tax on wages, thus probably accentuating even more its already marked unpopularity with high-salaried employees in government and elsewhere, the development of crude presumptive methods of tapping other incomes in the urban sector must constitute an essential component of tax reform in Papua New Guinea.

Taxing the rural sector. Papua New Guinea is one of the most rural countries in the world, with perhaps 95 percent of its population still residing outside the few small urban centres. It is also a federal democracy, which means it has an elaborate political superstructure of provincial governments where other countries might have unorganized rural municipalities. Experience everywhere suggests that direct taxation in rural areas works in nonauthoritarian states only when those taxed perceive real benefits to themselves from the taxes. What this means in Papua New Guinea is that such taxes almost certainly have to be provincial in character, which in turn means that the likelihood of developing and implementing such taxes is inextricably entwined with the need for a general revision of provincial finance, especially given the practical impossibility of levying land taxes in any case (Bird, 1984a; Axline 1986). What this means is that there is simply no feasible way to tax the rural sector directly.

The only way to increase revenues from the rural sector, if desired, is through increased taxes on agricultural exports, notably the principal ones of coffee, cocoa, and coconut products. A low flat tax (now 5 percent) on these products was re-introduced in 1975, but a number of experts have subsequently recommended that this tax should be increased, altered to a sliding-scale basis, and treated as a prepayment of income taxes for those plantations that are subject to the income tax (Lam, 1984). Heavy export taxation may clearly have undesirable effects on both agricultural development and the level of well-being of many rural people (though mainly the better-off ones).

Nevertheless, if necessary, the yield of the present export taxes could be increased, particularly in years of increasing commodity prices, without unduly severe consequences in either equity or development terms. In any event, the complete absence of any administrative capacity to collect taxes in the rural areas in any other way means that export taxes are the only means available if rural taxation is to be increased.

Conclusion

To sum up, if Papua New Guinea's fiscal prospects are as bleak as they seem to be in the absence of substantial new mineral revenues, then an essential ingredient of any solution must be to adjust its tax structure to match its economic structure. The principal tax "handle" in the economy is clearly trade. Both exports and especially imports could bear somewhat heavier taxes than at present without inducing severe distortions in development patterns and without putting too much strain on the country's exceedingly limited administrative capacity (13). If even rough justice is to be achieved in direct taxation, increasing use will have to be made of technically crude but feasible presumptive methods that do not depend for their efficacy on either good record-keeping or the ready compliance of taxpayers. Only by thus turning back the fiscal clock does Papua New Guinea have much hope of developing a tax system that better matches its true economic and administrative conditions.

The Importance of Administration

Papua New Guinea is clearly a country in which limited administrative capacity is a binding constraint on tax reform. There is increasing evidence, however, that this problem is by no means confined to a few very underdeveloped countries. A recent survey by Richupan (1984a), for example, cites studies of tax evasion in different developing countries indicating that it is not uncommon for half or more of potential income tax to be uncollected (14). Matters are not much better with respect to indirect taxes (Rao and Pradhan, 1985; National Institute, 1986; Bird, 1985b) or property taxes (Bahl and Linn, 1985).

The scanty quantitative evidence thus accords with the common perception that there is widespread tax evasion in most developing countries. Moreover, even when there is not outright evasion, the tax structure in these countries is often designed, administered, and judicially interpreted in such a way as to ensure the emergence of a huge gap between the potential and the actual tax base. Sometimes this result is achieved crudely, as through the continued use in Guatemala after a major devaluation of values converted at the old exchange rate for purposes of customs duties (Bird, 1985a). Sometimes it is achieved through more subtle (and usually peripherally legal) exploitation of the peculiarities of banking and tax laws, perhaps particularly with respect to the widespread availability of tax "incentives" (15).

And sometimes it is achieved by the functioning - or nonfunctioning - of the appeals system (16). However it is accomplished, whether at the legislative, administrative, or judicial levels, the result in most developing countries is that there is a great discrepancy between what the tax system appears to be on the surface and how it actually works in practice (Gray, 1987).

The effects of this discrepancy are more important and pervasive than seems to be generally recognized. Not only is revenue "lost" but the elasticity of the tax system is also reduced - particularly, of course, in inflation when administrative lags alone will usually suffice to yield this result (Tanzi, 1977). The result is that additional revenue must continually be secured through a series of discretionary ad hoc rate increases and new taxes. The "patchwork" character of the tax system of many developing countries arises in large part from their inability to administer the taxes they legislate, which leads to a continual need to legislate new tax changes.

The incidence and effects of the tax system are as sensitive to how it is administered as is its yield (Archaya, 1985). Tax evasion inevitably undermines the horizontal equity of the tax system (17). Recipients of equal income, like consumers of similar products and owners of similar properties, are not in fact taxed alike, whatever the law may say (18). The income tax in most developing countries is in practice a schedular tax, with the effective tax rate depending largely on the source of the income and almost always heavier on wage than on self-employment or capital income. (Rezende, 1976; Oldman and Bird, 1977) Taxes on property are even more sensitive to administrative interpretation, with old buildings being favoured over new, and so on. (Bahl and Linn, 1985) Even in the case of sales and excise taxes (Cnossen, 1977), in practice the products of small firms are usually favoured (19).

Moreover, most divergences between law and reality also serve to undermine the vertical equity of the tax system. It is the well-to-do who can most readily arrange for the law to contain convenient loopholes in the first place, and to exploit them once they are there with the aid of the "rent-seeking" skills of tax accountants and lawyers (and the consequent waste of scarce resources). The same group receive much of their income in the forms that are hardest to track down; they may also more readily hold their wealth, and even spend it, in ways hard to detect (e.g. offshore). Finally, they can not only most readily bribe and subvert administrators but they have the most to gain from doing so. Since the incidence of a tax is the resultant of the interaction of statute law, the opportunities different groups have to evade it, and the rigour with which it is enforced - and the rich come out ahead on all three counts - it seems clear that taxation in developing countries is, as a rule, unlikely to cause much disturbance to the inhabitants of the upper ranges of the income distribution.

For similar reasons, the real incentive effects of the tax system may be quite different from those that may be surmised from the statute. The global progressive personal income tax established by law is in practice likely to amount to little more than at most a mildly progressive tax on wage-earners in the modern sector (20). The equally formidable looking modern corporate income tax may turn out to be a crude gross receipts tax in practice (21). Even an apparently general ad valorem sales tax may in practice amount to little more than a collection of specific excises on a small fraction of consumption (22). In these circumstances, comparisons of the merits of general income or consumption taxes, or lamentations about the heavy burden imposed on capital by nominally progressive income and corporate taxes, may sometimes represent more obeisance to current trends in the academic literature than serious analysis of tax reform.

The tax administration - and hence feasible tax policy - in any country inevitably reflects to a large extent the nature of the country itself (23). If the country is a sea of corruption, as some are, the tax administration will not be an island of incorruptibles, and it is foolish to pretend it is. If most traders in the country are illiterate and keep no written records, no accounts-based tax (such an income or general sales tax) can effectively be levied on them, and it is futile to pretend to be doing so. Similarly, if land titles are in chaos or nonexistent in rural areas, no effective rural land tax can be levied. If officials are judged solely by the tax revenue they produce and little else - as was long the rule in the western world (Webber and Wildavsky, 1986) and is still true in some developing countries - they are likely to get that revenue from the politically weaker sectors of the population (such as ethnic minorities), regardless of what the law says. If the only way for an honest official to make a living wage is to claim travel allowances, then he is forced to travel even if it is a complete waste of his time. If only the incompetent and the untrained are left to deal directly with taxpayers, as is the case in many administrative systems where advancement comes only in the form of being promoted to a desk job, then taxpayers will meet only the incompetent and the untrained.

This catalog of woes is not easily remediable even in principle, let alone in practice. In many developing countries, the honesty of both taxpayers and tax officials is suspect (Virmani, 1987). Governments have little control over officials, little information as to what is going on, and no easy way to get it (Gray, 1987). Even if the information were available, the problem is inherently complex: market structures (and hence adjustment costs) vary widely, as do risk and time preferences, so that the costs, probabilities, and benefits of detecting evasion and corruption vary widely (Virmani, 1987). Administrative cost functions are discontinuous and hard to interpret (Bird, 1982). Tax schedules, the interpretation of the law, the penalty schedule, and the appeals process all vary over time, as do enforcement efforts - and the reaction of taxpayers to such efforts (24).

In the circumstances, it is not surprising that many tax analysts ignore the problem of tax administration - a problem epitomized in many countries in the phrase of Gray (1987, p.32), "All taxes are negotiable" - perhaps in the hope it will go away on its own. Even some of those most aware of these problems have in effect done this. Taylor (1967), for example, who wrote a perceptive piece on tax administration in Nigeria two decades ago, began his paper by saying these were only short-run problems which would undoubtedly be resolved in 20 or 25 years. An official report in Papua New Guinea (1971) similarly said of the income tax that doubtless, by the end of the decade, its reach will have extended throughout the population. Both these predictions, like similar ones made in other countries, proved to be wildly optimistic, proving once again that "the first law of finance is inertia" (Webber and Wildavsky, p.214).

Many tax reform proposals in developing countries have not paid even this passing obeisance to the problem of tax administration. Indeed, some reform proposals would make the life of administators even more difficult. As Surrey (1958, pp. 160-61) put it in his seminal paper:

> The tax administrator on the one hand sees new burdens falling on his shoulders - new taxes being imposed and existing levies becoming more severe. He must collect more taxes, at higher rates, and from an ever expanding body of

> taxpayers. On the other hand he finds himself saddled with a staff which is insufficient, inexperienced and poorly paid. He faces a public in large part unfamiliar with the tax knowledge and record keeping requirements which a developing state must inevitably demand of its citizens. He cannot obtain the needed support from the legal and accounting professions....Finally, he often must 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 necessarily paid for civilized society.

It is no wonder that tax administrators may view would-be tax reformers to be little more than residents of an ivory tower, who descend after the battle is largely over to shoot the wounded (25).

One reason for this apparent disinterest in administration may be, as McLure (1982) suggests, that it seems hard to go beyond platitudes on this subject. A more basic reason, however, has less to do with platitudes than with attitudes. As has been noted with respect to budget reform: "It may finally dawn upon observers that the peoples involved must not want to succeed all that much if they keep failing" (26). To put the point another way, if after thirty years of persistent nagging there has been so little perceptible improvement in important aspects of tax administration in developing countries, it may perhaps be safely assumed that the next thirty years are likely to mean more of the same (27). Whether this administrative inertia shows that a society gets the tax administration it wants (or deserves)- perhaps because taxation reflects the reality of political power (Best, 1976) - or whether it simply shows that no administration can be much different from the society of which it is a part, is less important than the fact of its existence. Neither quick fixes nor head-on confrontations seem likely to change matters much in the foreseeable future in most countries. Tax administration will thus remain a binding constraint on tax reform. In these circumstances, what can be done?

Coping with Administrative Reality

Broadly speaking, the solutions to the administrative problems of tax reform found in the literature may be divided into three groups: those that would change the environment, those that would change the administration, and those that would change the law.

Changing the Environment

Academic economists discussing policy issues sometimes sound as though they are, in effect, advocating that the way the world works should be changed to fit the conditions assumed in their models. Tax reformers discussing the need to change the institutional context within which a tax system functions often sound equally futile.

It is a commonplace, for example, that modern direct taxes depend to some extent on what is usually called "voluntary compliance". Even if such compliance is perhaps often motivated less by civic conscience than by the fear of being caught, it would clearly be exceedingly difficult, perhaps impossible, to administer such a tax if every hand were always raised against it. One cannot put the entire population into jail. Equally, however, one cannot will into being a spirit of compliance that is not there. If, as has often been said, the willingness of taxpayers to comply with their obligations depends to a large extent upon their perception that the funds thus taken from them are put to some good use and that they are treated fairly when compared to other taxpayers, then the fiscs of most developing countries are in deep trouble indeed (28). These conditions do not now prevail, and in many cases are not likely to prevail in the near future.

Several ways of attempting to remedy this serious "environmental" defect have been mooted. One is simply to undertake a campaign of "taxpayer education", to convince taxpayers that - in Justice Holmes's phrase (cited earlier in the quote from Surrey)- taxes are the price paid for a civilized society, that they live in such a society, and that the tax system is equitable. Such campaigns to encourage compliance are unlikely to do much good, however, if reality is too obviously different. As another famous American, Will Rogers, once said: You can fool all of the people some of the time, and some of the people all of the time, but you cannot fool all of the people all of the time.

Words alone are unlikely to change basic attitudes. Deeds may do so, however, so another approach is obviously to turn government into something which people see as adding to their lives rather than a burden (29). Thorough-going expenditure reform, increased use of devices such as earmarking and benefit taxes that link taxes and expenditures in some believable way, the devolvement of functional and financial responsibilities on local communities - such fundamental changes in the way government is conducted may indeed lead to a change in the attitude to taxation over time, and hence make the work of the tax collector, if never pleasurable, at least acceptable (30). The perceived fairness of the tax system may of course also be a factor in shaping attitudes.

Fundamental changes in such matters, however desirable, by definition, cannot be made easily or quickly, so there is little immediate hope for relief from this source. On the other hand, one should not overdo the importance of securing any particular concept of equity in the context of the tax system. Most developing countries are at best limited democracies or constrained autocracies. Even in the most democratic such countries, as a rule only limited groups are both tax-sensitive and politically significant. Most governments seem more concerned with the tax concerns of the few who matter than with the burden on the many (31). The tax treatment of the population as a whole sometimes seems to be considered primarily in terms of how to secure the necessary revenues with the least fuss (32). The "ability to pay" doctrine as it applies in some countries thus seems concerned more with the ability of the government to make people pay than with abstract notions of equity.

The only appropriate role for tax policy advisers in this context is to trace out as carefully and convincingly as possible the consequences of particular measures, leaving the decision about their acceptability up to the presumably responsible authorities. If administrative feasability is as important as suggested here, and it is easier to administer a system which is, as conventionally viewed, not very equitable, then so be it (33).

Changing the Adminstration

Another approach to relieving the constraints imposed on tax reform by administrative limitations is to tackle those limitations directly. Some proposals for administrative reform, however, seem to amount to little more than looking reality squarely in the eye and passing on. An example is the common suggestion that an elite corps of tax administrators should be created - an idea which dates back at least to Kaldor (1956) and perhaps in part has its roots in some fuzzy notion of the great days of the British Raj and the Indian Civil Service. This hoary chestnut deserves to be put aside for once and all (34).

In the first place, any tax administration is part of the public service generally. Consequently, it is, as a rule, no more than a fantasy to think that it can for long be pulled out of the ruck of political favoritism, employment-generation, and the myriad other factors that account for the masses of low-paid, poorly-trained, poorly-motivated public servants found in most developing countries (Goode, 1981). Secondly, even if such an elite could be created, they cannot do the job properly without both good soldiers (the front-line clerks, tellers, and so on) and adequate tools (computers, communication systems, etc.) neither of which is likely to prove easy to procure in developing countries, particularly for usually low-status revenue agencies (35).

An even more popular way of ignoring the administrative problem is to pretend it can all be handled by a small staff equipped with appropriately up-to-date computers. There is no doubt that in certain areas of tax administration, good use can be made of computers and that, indeed, they may in some instances obviate the need to acquire the skills of many highly-trained specialists (Lane and Hutabarat, 1986).

On the other hand, as experience has shown in all too many countries, the computerization of tax administration is a complex task that has as yet been successfully accomplished by few. Computers must be programmed and operated by people; they must rely on information obtained and inputted by other people; and their output must be acted upon by still other people. Since the motivations and incentives of all these people are unlikely to be altered by the introduction of new equipment alone, it is by no means obvious that the dawning of the computer age has significantly reduced the importance of the administrative constraint on tax reform in developing countries. Indeed, it is not hard to find instances in which the inappropriate introduction and use of computer systems has in some ways made matters worse. On the whole, computerization is clearly most useful where the tax administration is already well-organized (Corfmat, 1985).

Too often, as was recently noted in India, the tax administration is "neglected" and "archaic", characterized by poor training, low status, poor salaries, and poor equipment (Archaya, 1985, p.362). An obvious remedy is to tackle these and other organizational and procedural problems head on: to see that the law is properly drafted and codified; that the administration is properly organized, staffed, and trained; that taxpayers are located, placed on the rolls, and their returns adequately examined and audited; that relevant information is obtained from other government departments and elsewhere and properly utilized; that controversies between taxpayers and the administration are satisfactorily resolved; that taxes due are collected; and that penalties are properly applied. This is the approach taken by

Surrey in the seminal paper cited earlier (cf. Kelley and Oldman, 1973).

It is also the approach suggested in an interesting recent paper by McLure (1982). McLure's discussion of why the high hopes held for the 1974 tax reform in Colombia (McLure and Gillis, 1974) were so quickly undermined - not least by the judicial overthrow of critical administrative parts of the reform package - led him to propose the establishment of a high-level commission focusing on the reform of tax administration rather than tax structure. What is interesting about this logical proposal is that it appears unique in the tax reform literature: no one, anywhere, has done much along these lines. Even if someone did, however, it is by no means clear that any useful action would result, as experience with attempts at administrative reform have shown in many countries (36).

Interestingly, perhaps the oldest means of dealing with the administrative problem is to "privatize" tax collection. "Tax farming", as this practice is known, has a bad name in view of the gross injustices to which it led: but it also had real virtues in many countries during the centuries when it was the dominant form of tax collection. In particular, it ensured a reliable and steady stream of revenue into state coffers. The practice went out of favour in Europe when modern public administrative structures began to emerge in the 17th and 18th centuries (37).

Of course, no one would recommend the revival of tax farming today. Some important features of tax administration in many developing countries, however, are not dissimilar to tax farming in both their good and their bad aspects. Moreover, the recent spread of what is in effect private administration of important customs functions in countries such as Indonesia and Jamaica may signify a new legitimacy for this practice, although in some ways the use of a private Swiss customs service seems more equivalent to the famous Chinese Maritime Customs (largely set up and to some extent run by expatriate Englishmen), than to the tax farming familiar from ancient and European history (38).

As yet, not many developing countries have opted to hire foreigners, let alone local private firms, to collect their taxes on a commission basis, as opposed to the fixed fees characteristic of traditional tax farming (39). In practice, however, some aspects of how tax administration works in many countries are not dissimilar. The earmarked taxes common in Latin America, for example, are sometimes shared between the collecting agency and the state (Musgrave, 1981; Bird, 1984b). The "third party" collection systems that are the backbone of most effective taxes, also have a commission aspect, since the collecting agent (the withholding employer, the sales taxpayer) has the use of the funds for a legally or customarily agreed period before remitting them to the government (40). Finally, in all too many countries tax collectors are more or less expected to make up for their poor salaries by supplementary collections from taxpayers - collections which are not accompanied by a corresponding remittance to the government. In many such "corrupt" situations, indeed, there is a conventionally-accepted level of private reward to the fortunate possessors of official positions which is regarded as no more criminal than the equivalent rake-off by a cook from the household budget.

Yet another interesting variant of "official tax farming" which exists in some countries is to establish revenue targets for each auditor, tax official, or district tax office (41). If such targets are used as the sole basis of evaluating performance, and if compliance with such targets is considered essential to ensure an adequate flow of revenue to the central authorities, clearly such a system has both the virtue (stable revenue) and the vice (a license for extortion) of traditional tax farming. Moreover, unless the targeting system is altered, tax changes intended to alter allocative or distributive outcomes will not have much effect in reality, however refined their design, since the basic incentive of officials will still be to meet their targets by collecting the most they can from those least able to resist.

In other instances, of course, "targeting" may be simply a relatively innocuous device used as one part of an array of measures intended to keep administrators up to the mark. Indeed, one of the main purposes of such a system - and perhaps even its effect if there are adequate controls to restrain excessive zeal - may be to provide a higher degree of certainty to both the state and taxpayers. With respect to public as to private tax farming, full understanding of the possible merits and demerits of the practice requires a detailed examination of its context and effects (42). Labels alone are not grounds for condemnation.

Although what we think we have learned from history tends to turn most of us against such practices, many countries for many centuries have found it useful, even necessary, to thus employ private cupidity to serve public needs. Rather than outright condemnation of the desire of tax officials to feather their private nests, and pleas for the invention of "new model" men to replace the present unworthy vessels, one important component of a realistic study of tax administration in developing countries should be to devise incentive systems, perhaps at times including financial rewards, that will lead to a better matching of public and private interests.

Should this advice be acted upon, it would of course be important to have an effective system of controls to ensure that tax administrators do not steal the state (and the taxpayers) blind. As Webber and Wildavsky (1986, p.39) say, "...a tax collector's very function tempts him to cheat". Indeed, much of their lengthy history of fiscal administration is devoted to detailing the many ways over the centuries that sovereigns have tried to restrain this natural impulse of their servants. Rewards for good performance and penalties for poor performance; overlapping, duplicative, and redundant administrative structures (43); the division of functions among different officers, both to use each as a check on the other and to make it more difficult and costly to bribe them (44); the use of internal and external "spies" to check on the honesty of tax officials - all these devices and others have long been employed for this purpose in different countries.

The most basic way to ensure that tax officials do what they are supposed to do, and no more, however, is simply to reduce to a minimum the amount of discretion they have in dealing with taxpayers. The more room there is for negotiation between official and potential taxpayer the more scope there is for bribery by the one, arbitrary exaction by the other, and collusion by both. The more the tax to be paid is based on some readily measurable, observable, and verifiable base, the less scope there is for such maneuvers. If tax administration is to be effective and seen to be fair in the context of many developing countries it is thus necessary to apply clear, known, objective standards - however rough the ensuing justice - rather than leaving the application of a fine-sounding general statute to negotiations between taxpayers and officials (45).

Changing the Law

The best way to cope with the administrative problem is to design tax reforms for developing countries in full recognition of the severe limitations imposed by administrative realities. The administrative dimension is central, not peripheral, to tax reform. Without significant administrative changes, the alleged benefits of many proposed tax reforms will simply not be achieved, and, as a rule, it is unrealistic to expect such changes. Too many tax reform efforts have regarded tax policy and tax administration as quite separate matters. The world is not like that. No policy exists until it is implemented, and it is the manner of its implementation which really determines its impact. Those who would alter the outcomes of a tax system must therefore understand in detail how it is administered, and adjust their recommendations accordingly if they want to do good rather than ill.

There are at least three ways to approach the question of modifying the legal structure to accord with the administrative realities of developing countries: the first, to develop some gadgetry to bypass the problem, is a false lead; the second, to provide an adequate legal structure for administration, is obviously important but in itself inadequate; while the third, to design the basic tax law properly in the first place is, in the end, the only sensible procedure.

Gadgets. At least three types of tax "gadget" have been suggested to get around the administrative problem. The "lottery" approach in effect uses the cupidity (or gullibility) of taxpayers to make their interests congruent with those of the administration. Perhaps the best example of this approach is a scheme suggested by Hart (1967) to encourage customers to collect their sales receipts, so that they could enter them for lottery prizes (46). The idea is to obtain more reliable information on both the gross receipts of business and the expenditures of taxpayers.

One problem with such schemes is that it is unlikely the probability of a prize would be great enough to make it worthwhile for most people to comply. Even it it was, the seller could easily offset this incentive by offering two prices, with and without receipt (Casanegra, 1987). Another, even more serious, problem is that there is no conceivable way most tax administrations in developing countries could use the information thus provided, since they are already swamped with usable but unused information. An example is the provision found in some countries permitting the deduction of (e.g.) professional fees only on the submission of appropriate receipts. The idea, of course, is to aggregate such receipts and match them with the declaration (or nondeclaration) of the professional in question. Unfortunately, this never seems to happen (47).

For much the same reasons, the much-touted "self-checking" feature of the value-added tax has in fact amounted to little in most countries. This is one area, however, where computerization in principle could be the answer, although it does not as yet seem to have amounted to much in the case of other "information return" reporting systems (such as bank interest in Canada and the United States). Korea, for instance, matches all value-added returns on the computer (Han, 1987), although it seems unlikely that this elaborate exercise is much more productive than a properly designed selective audit system would be (48).

Another "gadget" is the proposal by Kaldor (1956), subsequently elaborated by Higgins (1959), for a "self-enforcing" tax system consisting of personal and corporate taxes on income and capital gains, combined in various ways with taxes on wealth, sales, gifts, excess inventories, and expenditures. Since this scheme has, quite properly in my view, been characterized by such authorities as Shoup (1969) and Goode (1981) as unworkable, and has in any case not been taken seriously anywhere, it will not be further discussed here. Much the same fate has been suffered by the proposal for a "self-assessed" property tax suggested by Harberger (1965) and elaborated by Strasma (1965), although in this case variants of such systems have in fact been employed in some countries, albeit without much success (Bird, 1984c). Once again, there seems to be no relief for the hard-pressed tax administrator in clever design. In the end, the only way to administer a tax is, alas, to do so.

A final, and the most popular, tax "gadget" is the tax amnesty. Recently there has been a revival of interest in this shopworn device as a result of some apparent success in, of all places, the United States. On the whole, however, there seems no reason to change the traditional view that this approach too is a loser unless, of course, the new day really has dawned and henceforth the tax in question will be fiercely and strictly administered. As Zweifel and Pommerehne (1985) have recently shown, however, many of those who support amnesties are willing to do so only if there is no subsequent tightening of administration. More importantly, history suggests that such tightening seldom follows in any case and that those who miss out on one amnesty can likely count on another one in the future (49). For these reasons, tax amnesties will doubtless continue to be more popular with politicians than with tax analysts.

Legal Framework. In contrast to the false hopes of gadgetry, there is clearly much to be gained by ensuring that the basic legal structure of tax administration (Yudkin, 1973) is set out properly. This path too will not lead to Nirvana. In particular, while it is obviously important to have a correct, and enforceable, set of sanctions (Oldman, 1965; Gordon, 1987), the notion that some seem to have derived from the theoretical tax evasion literature that all that is needed to deter evasion is a correct penalty structure is simple fantasy (50). The one-off game between a rational tax evader and a two-instrument administration postulated in this literature is too far removed from the real world to provide much useful guidance to tax designers or officials. So long as the probability of being caught is close to zero, as is the probability of being subjected to a severe penalty even if one is caught, then even within the framework of this model, there would seem to be little penalty design can do to alleviate real-world problems. Why would anyone who can costlessly evade a 50 percent tax rate hesitate to dodge one of 30 or even 10 percent? (51)

Adapting the Tax Structure. As with earmarking and tax farming, schedular taxation has long had a bad press, much of which has been well deserved. As in the other cases mentioned, however, wholesale condemnation of the schedular approach is by no means justified. The simple fact is that not only is the income tax in every developing country schedular in practice, but that the very nature of most such countries means that this outcome is inevitable, no matter what the law may say (Rezende, 1976; Oldman and Bird, 1977). It is not really possible to apply a "global" income (or consumption) tax in the circumstances of most developing countries. In reality, there are perhaps four income taxes in most countries: (1) a more or less progressive tax imposed through a withholding system on money wage income in the modern sector; (2) a set of more or less ineffective levies on the self-employed; (3) flat-rate withholding taxes on certain forms of capital income; and (4) a tax on the profits of large, and especially foreign, business.

The administrative case for a properly-designed set of presumptive taxes is especially strong in most developing countries (Bird, 1983). Obviously, such crude methods should not be applied in the more organized sector, from which most taxes are likely to be collected in any event (52) What can be done, however, is to concentrate the scarce administrative skills available in most tax administrations - the "detective" skills needed to uncover accounting fraud, for example - on those firms, seldom more than a few hundred in number, from which most taxes are collected, whether in the form of corporate income taxes, withheld personal income taxes, or sales, excise and payroll taxes, rather than dissipating them uselessly across a vast sea of noncompliant small and medium traders (Muten, 1981). This may not be fair, but it is reality.

For similar reasons, the concern often manifested with increasing the number of taxfilers may well be misconceived. Experience in the Philippines with respect to both income and property taxes, for example, suggested that most nonfilers were too small to warrant the cost of tracking them down. In such cases, scarce administrative resources should be concentrated on ensuring that the larger taxpayers, who are generally already on the rolls, comply fully with their fiscal obligations. In the case of the well-off and notoriously elusive "professional" class, whose noncompliance brings direct taxation into disrepute in so many countries (see, for example, Bahl and Murray, 1986, on Jamaica), the best approach, as with small traders and farmers, is to impose as stiff a presumptive system as can be implemented, with the better-trained officials being used to devise and adapt the standards rather than to deal directly with individual taxpayers (53).

The moral of this story is of course not that there is no place for an income (or other general direct) tax in any developing country. Indeed, it may even prove useful to package the diverse set of levies described above in a single income tax law (Oldman and Bird, 1977). The moral is simply that those who would design a better direct tax system for such countries should realize that the economic and administrative realities are usually such that what is really being done is to design a schedular tax. The tax analyst who approaches his task in this way is unlikely to make the same reform proposals as one who does not so take into account the way the world works.

In the income tax field, for example, the key to success is as comprehensive withholding system as possible supplemented by some sort of legally based presumptive assessment method on the "hard-to-tax" groups: both of these approaches will likely work best if rates are not too high or steeply progressive (Bird, 1983). In the sales tax field, for many countries the best that can be done is a physically- controlled excise system (Cnossen, 1984), though some use of the value-added principle may at times be feasible and desirable to reduce cascading (Bird, 1985b). As noted above with respect to Papua New Guinea, the many small, open countries with little domestic production and relatively low tariffs on most items may achieve much the same results by simply levying a uniform tariff on imports. As for wealth taxes, simple flat-rate taxes on urban and rural property are perhaps all that can be expected in all but the most advanced developing countries (Bird,1974).

Conclusion

The basic conclusion to which the preceding discussion leads is thus simply that those proposing tax reforms in developing countries should both understand thoroughly the existing administration and assess realistically the possibility of rapid improvement. Since many tax reforms that have been proposed in developing countries would complicate rather than simplify the work of already overloaded administrations, the failure to adopt or implement them successfully is not surprising.

The only solution to this problem is to design a tax reform that will "work", that is, produce better results than the existing system with an administration similar to that now in place. Complex schemes simply will not work in the conditions of most developing countries. Too often would-be tax reform-mongers have been led astray in the futile search for the perfect fiscal instrument in theoretical terms. The "perfect" in this sense, however, is too often the enemy of the "good" in the sense of a roughly acceptable tax system, that is, one which can be administered roughly and still produce acceptable results.

The "brave new world" of tax reform sketched in this paper may not sound either very brave or very new, but it is the world in which most developing countries are found. Moreover, since those who would change the world must first understand it, starting from such a basis appears to offer a better prospect of attaining an acceptably fair, and generally efficient tax system than the adoption of the latest up-to-date model of fiscal perfection from the academic drawing board.

Table 8 Papua New Guinea: structure of internal revenue, selected years 1952-87 (as per cent of total internal revenue)

	1952	1961	1971	1975	1980	1985	1987 (est.)
Import duties	39.6	30.2	30.6	17.2	15.9	20.3	24.0
Export taxes	20.8	-[a]	-[a]	6.1	2.8	2.6	2.2
Subtotal	60.4	30.2	30.6	23.3	18.7	22.9	26.2
Personal income tax[b]	nil	16.1	24.8	23.6	22.2	26.0	26.9
Company tax[c]	nil	14.8	14.8	40.8	32.0	21.0	19.5
Subtotal	nil	30.9	39.6	64.4	54.2	47.0	46.4
Excises[d]	nil	2.0	10.8	11.3	13.1	12.1	10.8
Other taxes	0.0	1.3	2.3	1.5	0.7	2.4	2.3
Subtotal	0.0	3.3	13.1	12.8	13.8	14.5	13.1
Total taxes (excluding BCL)	60.4	67.1	83.3	94.3 (75.0)	86.7 (70.1)	84.3 (78.0)	85.4 (76.9)
Non-tax revenue[e]	39.6	32.9	16.7	5.7	13.3	15.7	14.6
Total	100.0	100.0	100.0	100.0	100.0	100.0	n.a.
As % of market GDP	n.a.	3.4	15.4	21.2	23.8	26.2	n.a.

[a]There were no export taxes from 1959 to 1975.

[b]The personal and company income taxes were introduced in 1959.

[c]The figures shown here for company income taxes include dividend withholding taxes after 1971 as well as fl..: from the Mineral Resources stabilization Fund (which are therefore excluded from non-tax revenues).

[d]The first excise taxes were introduced in 1952/53.

[e]Non-tax revenues before 1971 are inflated by inclusion of public utility and postal revenues.

Source: ~~Appendix Tables 1 and 2~~ B, 6 (1987) ~~"Taxation in Papua New Guinea", 1987.~~

NOTES

(*) Professor of Economics, University of Toronto. The first draft of this paper was prepared while I was at the University of York, U.K. and this draft was prepared at Erasmus University Rotterdam. I am grateful to both these institutions for their hospitality. I am also grateful to the following for comments that have led to substantial changes and, I hope, improvements in this version, although of course none of those named are responsible for what I have done with their ideas: Sijbren Cnossen, Dennis Frampton, Malcolm Gillis, Charles McLure, Cedric Sandford, Carl Shoup, and Wayne Thirsk.

(1) This paper was originally delivered in 1954 to the International Institute of Public Finance; it was subsequently reprinted in all three editions of Bird and Oldman (1964,1967,1975).

(2) Naturally, there are exceptions to this assertion - as to most of the more sweeping generalizations made in this paper. The early report by Shoup (1959) on Venezuela, for example, paid considerable attention to administration (Surrey was a member of the research team). The later Musgrave reports on Colombia (1971) and Bolivia (1981) are more typical in confining their concern with administration mainly to the vexed issue of the

"hard-to-tax" groups. Even more characteristic of much tax policy work is the view epitomized by Kaldor (1980) that administrative deficiencies can and must be rectified to permit desirable policy changes. In contrast, the present paper argues that as a rule such problems will persist for a long time to come in most countries and that successful policy reform must take this reality into account.

(3) Surprisingly few studies have been made of the actual functioning of tax administrations in developing countries. Much of the best work by outside analysts is essentially non-quantitative (Joint Tax Program, 1965; Wilkenfeld, 1973; Radian, 1980); the same is true of most of the better published country studies (India, 1960, 1969; Joint Legislative-Executive Tax Commission, 1961), although there is at least one interesting exception (Colombia, 1985). Most of the available literature is essentially prescriptive (Public Administration Service, 1961; United Nations, 1967, 1968; Nowak, 1970; Kelley and Oldman, 1973). There appear to be almost no published empirical studies in developing countries of many of the key administrative issues touched on here: the costs and benefits of tax amnesties, the costs of rate differentiation and exemptions under sales taxes, administrative and compliance costs, the incidence and allocative effects of appeal procedures, the effects of revenue quotas and incentive systems, the costs and benefits of refund systems, audit selection procedures, and so on. This research agenda

obviously requires systematic exploration if the propositions asserted in this paper are to be tested properly. For a useful beginning, see Yitzhaki and Vaknin (1987).

(4) Despite the extensive references in this paper, it will be obvious to the careful reader both that this survey of a vast subject is selective and, more controversially perhaps, to some extent more impressionistic than based on hard evidence. One reason for this state of affairs is mentioned in note 3 above. In addition, it may be worth mentioning that every statement made can be supported by reference to at least one and often several examples, although I do not think it appropriate to bring out for public display the numerous instances of corruption, incompetence, low morale, and - surprisingly common, and most tragic of all - able and willing administrators starved of the tools and support they need to do their job, that I have encountered over the last 25 years in various parts of the world. In any case, the principal point of this paper is not to recite tales of woe but rather to assert that tax policy designers have not, as a rule, taken these realities adequately into account in recommending tax reforms in developing countries.

(5) In the long run, of course, as Webber and Wildavsky (1986) have recently shown in detail, in an important sense the tax system of every country reflects its own political culture (see also Hinrichs, 1966). Since in many ways Papua New Guinea's

nascent political culture is unique, its tax system too, when fully developed, may be unique in some respects. At least for the next few decades, however, the argument in the text seems valid.

(6) In addition, and probably more importantly, the present scale and structure of public expenditure needs to be curtailed (unless perhaps the revenues from several new mineral projects come in much more quickly than seems likely). These and many other matters are discussed in more detail in Bird (1987), from which the present brief account is abstracted.

(7) In particular, the consumption pattern of the (diminishing) expatriate population is much more import-intensive than that of nationals. In 1976-77, for example, 25% of all imported final goods were consumed by expatriates, who at that time constituted less than 2% of the population (Baxter, 1982).

(8) The number of tax returns processed by the tax department fell from 115,818 in 1980 to 10,581 in 1981. These figures, like the others in this paragraph, are taken from Papua New Guinea (various).

(9) Incidentally, both the equity and the efficiency of the fortnightly wage tax are suspect, as discussed in Bird (1987).

(10) The 1986 figures are based on an unpublished survey kindly made available by the Chief Collector of Taxes; the earlier figures come from Papua New Guinea (1983).

(11) Robson (1985), for example, expresses concern on this score. In principle, to avoid resource misallocation similar taxes should be levied on domestic equivalents. Given the severely limited administrative capacity, the absence of an industrial base, and the relatively low and uniform tariff structure, however, this danger is much less imminent than in many countries. This point - as well as why there is no revenue potential in company taxes, excise duties, or sales taxes - is dicussed further in Bird (1987).

(12) The assessment of the tax administration assistance program in the text is based on discussions in both Australia and Papua New Guinea (and reinforced by previous experience with similar projects in countries as different as Colombia and Egypt).

(13) For an unusual assessment of development policy in Papua New Guinea by a well-known economist which similarly pinpoints administrative capacity as the binding constraint, see Reddaway (1986).

(14) For additional evidence, see Richipuan, 1984b; Archaya, 1985; Bahl and Murray, 1986; Virmani, 1987. An earlier survey may be found in Herschel, 1978.

(15) As McLure (1982, p. 57) says, a tax advisor needs "...an appreciation of how the finest tax structure can be subverted by tax avoidance made possible by carelessly drafted statutes and regulations and especially by tax evasion facilitated by poor tax administration." Almost every technical assistance report contains other instances of defective structural design and poor administrative implementation which result in substantial revenue losses.

(16) The clearest instance of the judicial "perversion" of a tax system of which I am aware is actually in a developed country (Australia, under the "Barwick" court in the late 1970s). Although it would be invidious to name less-publicized names, it is not difficult to find similar instances in developing countries of judges apparently bound and determined to find in favour of taxpayers, or at least those rich enough to wait out the appeal process.

(17) Tax evasion also adds to the conventionally-estimated excess burden of taxation, as Yitzhaki (1986) demonstrates-although the significance of this finding is not clear when the

basic competitive conditions assumed in making these estimates are so obviously violated in most developing countries.

(18) Skinner and Slemrod (1985), taking the Feldstein view that old inequities are in fact capitalized, argue that heavy penalties on evaders will themselves violate horizontal equity. The conclusion that such penalties are inequitable seems unwarranted. At most, a case may be made for phasing in or signalling in advance the launching of an anti-evasion campaign to permit those in the wrong to regularize their affairs (for example, through an initial tax amnesty).

(19) In some instances, as in India and (formerly) in Indonesia, such favoritism was deliberate. Whether deliberate or not, however, this outcome also reflects the inability of the administration to tax smaller firms effectively.

(20) This is a good description, for example, of the situation in Bolivia a decade ago (Musgrave, 1981). In 1986, however, Bolivia followed a path quite different than that proposed by the Musgrave mission, when it abolished the income tax and replaced it by a set of consumption and asset taxes, calling the latter "presumed income" taxes (American Chamber of Commerce, 1986). Some aspects of this reform seem close to the lines suggested in this paper, although I have no idea of how (or if) it is actually functioning.

(21) The best description of this process at its extreme remains Hinrichs (1962). To some extent, the alternative minimum taxes of some countries in francophone West Africa as well as Colombia also work in the same direction: in Colombia in 1984, for example, one-third of all companies were taxed on a presumptive basis and about 13 percent of company taxes were assessed on this basis. For two-thirds of those taxed on this basis, the presumption was based on net wealth and for the others on gross receipts. The new Bolivian tax mentioned in note 20 above goes further, taxing all companies at a rate of 2 percent on net assets at the end of the year.

(22) This is the characterization of the Jamaican consumption tax that emerges from Cnossen (1984). Tanzi (1987) has noted that most so-called "general" sales taxes in developing countries amount to little more than a levy on imports and a few "excisables" and seldom cover more than 20% of domestic value-added.

(23) While it would be invidious to name names, it may be of interest to mention that each of the examples in this paragraph is drawn from personal experience.

(24) A particularly interesting discussion of this interaction is Boyd (1986), who draws an analogy with the

analysis of"predator-prey" relations. See also Mayshar (1986) who takes a longer time perspective, referring to "a slow Darwinian process of mutation and adaption."

(25) This characterization is adapted from the reaction of the Australian Commissioner of Taxes to a critical report on his office by the Auditor-General, as reported in Australia (1986a, p.64). It may be worth noting parenthetically that Australia-like most developed countries - suffers from some of the administrative ills stressed here e.g. inability to utilize existing information effectively (Australia, 1986b, 1986c) and the lack of a satisfactory taxpayer identification system. Of course, Australia also has a well-trained tax administration. The most significant difference from the typical developing country is that most taxes are collected through the agency of large, well-organized, and basically trustworthy companies.

(26) Webber and Wildavsky (1986), p. 609. Or, as Witt (1987,p.140), puts it: "Efficient and inefficient tax systems are not the result of some kind of 'happy' coincidence but of social and political power constellations."

(27) The slow course of administrative improvement may be illustrated by referring to three studies of Colombia over the years (Caldwell, 1953; Bird, 1970; and McLure, 1982). There have

clearly been substantial improvements in Colombian tax administration over these three decades, but progress has been slow and episodic and there is still a very long way to go. See also Colombia (1985).

(28) As Adam Smith put it: "In those corrupted governments where there is at least a general suspicion of much unnecessary expence, and great misapplication of the public revenue, the laws which guard it are little respected" (quoted in Skinner and Slemrod, 1985, p.353).

(29) It is particularly clear that governments should not, as some now do, burden even willing taxpayers with such unnecessary discomforts as the need to stand in long queues to file returns or pay taxes, needless requirements to submit numerous copies of returns, and even charges for supplying returns in the first place.

(30) Earmarking was traditionally employed more as a means of controlling the purposes to which tax collectors put the funds they extracted than as a means of encouraging taxpayers to tolerate their exactions (Webber and Wildavsky, 1986), but it has also been advocated at times in part for the latter reason. For further discussion of this and most of the other points mentioned in this paragraph, see Bird (1984b).

(31) Tax advisers who have found themselves involved in interminable discussions on the fine points of income taxes which affect at most 1 percent of the population, while being unable to get anyone to listen to their concerns about the effects of some much more important tax on the other 99 percent, should understand this remark. On the other hand, even the most autocratic regimes are restrained in their exactions by the fear of revolt, either by the masses or their more powerful supporters.

(32) Webber and Wildavsky (1986) provide various examples of the various sayings to this effect that have come down through the years, although they somehow manage to omit the famous remark, usually attributed to Colbert, about geese, feathers, and hissing.

(33) Moreover, as Wedderspoon (1969,p.55) put it: "It is a question whether truer equity could not be achieved (and the other consequences more realistically anticipated) by an instrument which was less zealously aimed at the abstract, which was more closely oriented to the immediate capacity of available administrative resources, and which paid greater attention to the prevention and detection of fraud - a factor which experience shows can have greater relevance to equity than tax policy itself."

(34) A more promising approach is to establish what is in effect a new tax administration, for example, by contracting collection of export taxes to the central bank or some other "reliable" organization, or by creating a new quasi-independent revenue authority (such as the Revenue Board in Jamaica). Such measures may be effective for a period, but over time the bad old ways are likely to creep in again - except, of course, in the unlikely event that the underlying factors creating the problems in the first place have been corrected.

(35) In a private communication, Sijbren Cnossen makes the interesting argument "...that tax administration should take a back seat in the modernization process. Modern taxes, like the income tax and a broad-based sales tax, are accounts-based taxes. To enforce these taxes properly, tax departments need auditors. But auditing skills are hard to acquire and auditors are a scarce commodity. Even if auditors can be found they should probably be employed in roughly the following order: private sector, public enterprises, government expenditure programs -- before they are put to work in a tax department."

(36) In Jamaica, for example, there have been at least seven attempts to reform important aspects of the public administration since independence: none has succeeded to any noticeable extent.

(37) This brief history is based largely on Webber and Wildavsky (1986), who trace this practice back to Mesopotamia. One example is the English customs, which was farmed until 1671, and even later in Scotland (Carson, 1972): indeed, until well into the 19th century many officials were still paid on a fee basis.

(38) Kaldor (1980, p.x) actually cites the Chinese example as one that should be emulated by India.

(39) This change in the fee basis obviously obviates some of the worst problems with tax farming. The basic problem with privatizing monopolies like revenue collection, however, is to specify the terms of the contract, especially since the most economic methods (from the contractor's point of view) are unlikely to be acceptable to modern governments. Indeed, if the contract is adequately specified, and compliance with it sufficiently monitored, it would probably be as efficient for the government to do the job itself!

(40) Sandford (1981) analyzes this aspect of VAT carefully. See also Due (1987) who notes that a number of European countries allow small sales taxpayers to retain some of the tax for their trouble.

(41) This description is in part based on Indonesian practice in the early 1980s. (Until 1971, an explicit bonus was paid to those exceeding collection targets.)

(42) In the case of Indonesia, for example, targetting may be condemned as arbitrary, inequitable, and discouraging administrative effort. Alternatively, it may be accepted as conforming to local standards of fairness and administrative probity while providing a modicum of oversight and not affecting administrative effort adversely (since close examination suggested that the effort tended to establish the targets, rather than vice versa).

(43) Such devices may in practice often hinder the honest more than they deter the unworthy. A classic example is the Contraloria system in some Latin American countries (Bird, 1982a).

(44) A good example is the development in the British Customs service (Carson, 1972) of the "triangular control" system - valuation, collection, and checking - which is still in use in much of the world. For similar reasons, the separation of assessment and collection functions is often recommended for other taxes.

(45) Even in developed countries, "provisions which rely unduly on administrative discretion risk being applied arbitrarily, unfairly and selectively" (Ireland, 1985, p.55).

(46) Such schemes are actually employed to various extents in some Latin American countries, Turkey, and Taiwan.

(47) Similar problems are not unknown in developed countries: witness the recent condemnation in Australia (1986b) of the collection of useless (and unused) information in the "naive belief" that it will ensure compliance.

(48) Interestingly, while it is clearly possible in principle to develop an "optimal" audit system (Balachandran and Schaefer, 1980), in practice it appears that the most rewarding way to proceed is still the old method of "leads and experience" (Due, 1985).

(49) In fact, it might even be suggested that to the extent an amnesty successfully increases revenues, it often tends to reduce administrative efforts! As no comprehensive analysis of tax amnesties in developing countries appears to be available (but see Pepper, 1966), this conclusion is necessarily based on limited personal experience, particularly in the Philippines and Colombia.

(50) The theoretical literature has now become so large that all that can be done here is to note that it started with papers by Allingham and Sandmo (1972) and has since grown like wildfire. For three useful summaries by the IMF's Fiscal Affairs Department, see Sisson (1981), Richupan (1984c), and Mansfield (1987). As Mansfield (1987) notes, the basic problem with the theoretical literature is that for the most part it ignores the constraints that permit the system to function at all.

(51) For a formal argument suggesting that evasion is basically independent of the tax rate, see Yitzhaki (1986).

(52) But note the case of Bolivia (American Chamber of Commerce, 1986).

(53) That is, what is proposed is a presumptive rather than a <u>forfait</u> (negotiated) system : for further discussion, see Tanzi and Casanegra (1987); Morag (1957); Lapidoth (1977).

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