

Chapter - VI : Conclusion

This work integrates three issues, namely, tax evasion, corruption and privatization. Literature is replete with separate research on all the three issues in their own right. However, the relevance of the approach transpires when privatization is considered as a way around the problems of bureaucratic tax enforcement. Bureaucratic tax enforcement has various problems that render the revenue generation systems inefficient. However, for many governments, the most difficult problem is corruption by venal tax-officials who connive with taxpayers and allow evasion attempted by them. The question examined in this work is : can the problem of tax evasion in a corrupt tax bureaucracy be tackled through privatization?

Bureaucratic inefficiency is the factor that is usually forwarded as a rationale for privatization of public activities. The tax system is no exception. It has been emphasized in this paper that bureaucratic inefficiency is a comparative claim that should be analyzed with reference to the context. An efficient tax system is one in which the divergence between potential and actual collection of revenue is minimized. The divergence is the consequence of taxpayer non-compliance leading to evasion.

In a bureaucratic regime, the responsibility of the tax-officials is to minimize this divergence by detecting and stopping attempts at evasion. However, efficiency of the tax system is threatened by moral hazard as tax-officials connive with the tax evaders and allow

evasion in exchange for bribe. This is a crucial problem of control faced by the government in a bureaucratic mode of tax enforcement.

However, the problem of control may develop also under a private regime. This is particularly so under a pervasive moral hazard situation as often observed in a large number of developing countries. However, with the private sector operating in place of bureaucracy, the degree of the problem is different for the government. So, with regard to tax enforcement, the choice of institutional arrangements has been posited as a choice between the alternative levels of the problem of control.

In analyzing the problem of control due to moral hazard, the concept of market in corruption [Chowdhury, 1991] was invoked. It was postulated that the efficiency of a tax system under any regime would depend on the efficiency of the market in corruption around revenue administration. So, some critical factors operating in the market in corruption and affecting its efficiency were identified and analyzed. The underlying assumption is that the level of corruption depends on the impact of these constraints on the transacting agents.

Since transacting agents may be individuals as well as organizations, so in developing the model of market in corruption, moral-psychological as well as structural constraints were identified and considered. Five constraints as such are 'accountability management', 'uncertainty', 'social stigma', 'negotiation' and the opportunity cost of maximizing present income reflected in 'discount rate applied to future'. These impose costs on the transacting agents and restrain many 'possible' transactions from taking place.

However, the critical point is that they affect the behaviour of the private firms very differently from that of the individual tax-officials. In a bid to minimize these costs, individual tax-officials

exercise self-restraint. As a result, many feasible opportunities of corruption remain unutilized and the possible level of evasion is brought down thereby. On the other hand, the impact of the constraints on the private firms is little, and the outcome is a more intense and wider scale of corruption.

In other words, under a private regime, different transaction costs of operating in the market in corruption are significantly reduced, and the resulting gain in market efficiency encourages and facilitates transactions between the suppliers (tax firms, e.g. PSI agencies) and the consumers (taxpayers) of corruption. As the market operates efficiently, more opportunities of corruption are generated and utilized, and also, the scale of corruption widens up. In turn, the demand for and supply of evasion rises substantially under a private regime relative to tax bureaucracy. The result is a wider scale as well as higher levels of evasion.

The theoretical framework developed in this paper for understanding the inefficiency of a corrupt tax bureaucracy constitutes a departure from decision-theoretic and game theoretic approaches. It has enabled us to develop a more realistic framework for analyzing the corrupt behaviour of public employees causing inefficiency in revenue generation through corruption. The particular utility of this framework is that it can explain variation in the severity and scale of evasion through corruption regardless of the rigour of enforcement. Indeed, in the real world, deviant behaviour varies despite constancy of the level of enforcement.

However, unlike purely economic models, the new framework of analysis can not neatly show where the equilibrium will be struck in the corruption-market in a tax bureaucracy. This is because it can not rationally assume a maximizing behaviour on the part of the participating parties. Exercise of self-restraint and selectivity due to the constraining factors prevents any such maximizing behaviour. In reality, behaviour of tax-officials engaged in corruption turns out to be unsystematic and discontinuous.

The case study used to illustrate the theoretical framework thus developed rests on data collected from primary sources. The study of the Bangladesh case of privatization of customs enforcement in 1992 exemplifies how the efficiency of the market in corruption in customs administration was fuelled under a private regime causing massive evasion on an unprecedented scale. It was a fallacious presumption that the private sector was incorruptible and that they could be safely substituted for the customs officials so as to curb down the level of evasion through connivance. As the pre-shipment inspection firms started to function, it became apparent before long that they also posed a great threat to revenue. Not only that the private firms engaged in corruption, indeed they proved to be more corrupt than the tax bureaucracy is. Soon it was obvious that switching to a privatized regime was a fatal blunder. The futility of the cost-benefit analysis carried out for rationalizing the introduction of the PSI system was established beyond doubt. Eventually, the government initiated a process of policy reversal to safeguard revenue. The scope of the PSI system was gradually narrowed down to protect revenue.

The model developed in this paper has been useful in explaining the relatively more corrupt behaviour of the private firms. For the PSI firms, the question of accountability was little and negligible. Their involvement in evasion could be pre-planned with certainty. They had insignificant social costs in engaging in corruption. Negotiation in corrupt deals for evasion was almost unhindered. In maximizing current income, their opportunity cost of discounting future income at a high rate was low.

In all, they could afford to be much more promiscuous and much less selective in utilizing opportunities of corruption than the government customs officials would do. In sum, transactions and opportunity costs of engaging in evasion was substantially lower for the PSI agencies and evasion through corruption was effectively

institutionalized. As a consequence, once inducted into corruption, the PSI agencies facilitated greater levels of evasion than the individual tax-officials would ever consider.

Policy reversal

As the introduction of the PSI programme backfired, the Custom House at Chittagong, the largest port of importation in Bangladesh⁴⁴, recommended withdrawal of twenty two items from the facility available under the PSI programme. These were the items causing large-scale revenue leakage because of wider levels of evasion as well as huge import volume.

Initially, the NBR withdrew the facility from four items, namely, cigarettes, powdered milk, Cloves and Cumin seeds, through two different official notifications. Soon other items were considered too vulnerable for PSI because of large revenue implication. As a result, the facility was discontinued in respect of seven further items including second-hand (reconditioned) cars, through a subsequent notification.

The Tariff Commission, the Ministry of Industry and different Chambers of Commerce and Industries recommended withdrawal of the facility from another 20 items including peas, tallow, sulphuric acid, hard board, paper, yarn, sheet-glass, transformers and bicycles.

Later, the list of withdrawal was extended to 18 sets of items through a Notification dated 25.02.1997. This was further extended to 38 sets of items through a Notification dated 13.05.1997.

Given the way that the situation was evolving, it appeared that, if the PSI agencies do not improve the credibility of their operation, the government may totally discontinue the system in the near future. To recollect Sieber [1981] : policy reversals often

⁴⁴ Chittagong Custom House accounts for more than 65 percent of taxes collected through the customs stations of the country.

follow from 'fatal remedies' which produce intolerable unintended outcome. In fact, by the middle of 1997 the scope of the PSI system was so much narrowed down that its importance was eroded to a large extent. It was no longer a reliable option for most of the importers who sought evasion. It was expected that the government will soon opt for total discontinuation of the PSI system.