The World Bank

PREM notes

OCTOBER 1999

NUMBER 33

PUBLIC SECTOR

An anticorruption strategy for revenue administration

A recent review of World Bank loans for tax and customs reforms reveals the potential of such projects for anticorruption efforts.

The Bank defines corruption as the abuse of public office for private gain. Corrupt actions include the unilateral theft of public property by its steward and multiparty transactions in which beneficiaries bribe officials. Corruption can exist at all levels of public administration—from the highest officeholder to the lowest functionary. Because tax and customs administrations often figure among the corrupt government agencies in developing countries, Bank projects that reform these administrations should include anticorruption efforts.

Any strategy to combat corruption must limit the motives and opportunities for public officeholders to abuse their positions. This should be done directly for unilateral corruption, while for multiparty corruption it can also be done indirectly by focusing on the supply side of bribes. Although we do not know enough to identify optimal anticorruption strategies for different country situations, there is no one-size-fits-all strategy. Various elements from the menu of possibilities must be integrated into a coherent package. The Bank's approach in this area, outlined below, is in broad agreement with that of the International Monetary Fund (IMF).

Motives for corruption

Potential reforms for discouraging corruption among revenue officials are listed in box 1. A few deserve elaboration. Sufficient organizational autonomy of the revenue administration, combined with performance-linked budgets, is often advocated as a way of achieving efficiency. Competitive base pay and transparent and nonarbitrary reward procedures are also widely recommended. But little analysis has been done to determine the size of the salary increases needed to reduce corruption. Moreover, such increases can impose a considerable burden on the budgets of developing countries.

Additionally, positive incentives for revenue officials, if unchecked, may lead to overzealous harassment of taxpayers, which is also a form of corruption. For this reason, and to penalize other corrupt actions, negative incentives should complement positive incentives. (Using negative incentives alone, however, could deter not just corruption but also the will of revenue officials to work.) Finally, independent taxpayer surveys can help identify elements of the organization, or even individual tax offices, that harbor severe corruption.

Any anticorruption strategy must limit the motives and opportunities for public officeholders to abuse their positions

Box 1 Addressing motive

Basic motivation
- M1 Mission and vision statements
- M2 Elite ethos and esprit de corps

Positive incentives
- M3 Organizational autonomy
- M4 Transparent budget procedures and performance-linked budgets
- M5 Performance-linked compensation
- M6 Intra- and interagency competition
- M7 Competitive base pay
- M8 Transparent and nonarbitrary reward procedures

Negative incentives
- M9 Effective sanctions for corruption
- M10 Stronger taxpayer voice through independent surveys
- M11 Citizen review and oversight

Supply-side elements
- M12 Effective sanctions for bribe payers
- M13 Independent institutions to protect taxpayers from harassment and extortion
- M14 Publicity for penalties

Opportunities for corruption

An anticorruption strategy must do more than address incentives, however. Opportunities for corruption also need to be curbed (box 2). Tax simplification is perhaps the most important method of limiting opportunity, and can also increase economic efficiency for other reasons. Tax reforms in many countries and Bank-IMF advice generally focus on lowering tax rates, broadening the tax base, and eliminating special exemptions. Such reforms tend to make tax obligations transparent and reduce the compliance cost of honest taxpayers. Presumptive taxation of small businesses, which may not keep extensive books and records, can also reduce the discretionary power of tax inspectors and make tax calculations simpler and clearer.

Anticorruption strategies need to focus on a few crucial elements rooted in the specific characteristics of each country

Organizational and management reforms that can form part of an anticorruption strategy include clearly dividing responsibilities along functional lines and relying on transparent, written procedures. Effective implementation of such standards depends on the state of development of the tax administration and the economy.

Perhaps more important is a system of internal and external checks. Internal audit divisions and anticorruption units are the most important anticorruption bodies within revenue administrations. Important institutional safeguards outside the revenue administration include an independent and effective judiciary, external reviews by government agencies (such as independent external audits), and taxpayer associations that strengthen citizens' voice.

Excessive contact between taxpayers and tax officials should be avoided. Important instruments in this regard include relying on withholding taxes, increasing the use of third-party data for tax assessment, and privatizing selected functions of tax administration. Effective automation of procedures also facilitates reduced contact and increases administrative efficiency.

Box 2 Addressing opportunity

Tax structure reforms
- O1 Low and few rates and limited exemptions
- O2 Withholding and presumptive taxes
- O3 Nondiscretionary penalties

Organization and management
- O4 Functional organization
- O5 Increased use of third-party data
- O6 Limited contact with taxpayers and suppliers
- O7 Arm's-length, transparent, and nondiscretionary business procedures
- O8 Transparent human resource, procurement, and budgetary procedures
- O9 Computerization and automation
- O10 Privatization of selected functions

Internal and external checks
- O11 Independent internal and external audits
- O12 Effective management supervision procedures
- O13 Citizen review and oversight
- O14 Internal anticorruption units

Incorporating strategies in reform projects

An examination of 43 Bank loans in the 1990s with major revenue modernization components revealed that most projects that explicitly targeted administrative corruption occurred after 1997. Earlier operations rarely incorporated parallel judicial reform (absent in 95 percent of projects examined), budget determination and transparent budgetary procedures (90 percent), presumptive taxes (88 percent), external and internal audits (80 percent), and elements for strengthening taxpayer voice or introducing other external oversight institutions (78 percent). Several projects focused mainly on automation and computers, recognizing their potential to facilitate standardized, arm's-length procedures.

Given the limited capacity to absorb change in most developing countries, anticorruption strategies need to focus on a few crucial elements rooted in the specific characteristics of each country. A variety of designs have been suggested in technical reports and incorporated in ongoing projects.

Current country approaches

Strategies in Latvia, Guatemala, and Tanzania are representative of anticorruption efforts in recent Bank technical assistance (table 1). Latvia is a small, highly urbanized country with GNP per capita of $2,400. Guatemala is much less urbanized—60 percent of its citizens live in poor rural areas—and has more than five times as many people as Latvia, with GNP per capita of $1,500. At 31 million, Tanzania's population is nearly three times Guatemala's, and its GNP per capita is $210.

Tax revenues as a share of GDP are low in Guatemala and Tanzania. In Guatemala in 1996 they had declined to 8 percent, one of the lowest levels in the world. Tanzania's tax revenue was quite low for its region, at 12 percent. In contrast, Latvia's was a healthy 31 percent during 1995–97 but was below spending levels. All three countries benefited from a public and government consensus about the need to reform their tax agencies, as well as the need to combat corruption through direct action.

Latvia's anticorruption strategy for revenue administration was part of a broad national strategy guided by a Vigilance Unit. International experience had shown that in transition economies revenue administration is severely tested by corrupt taxpayers and officials, high volumes of cash and cross-border transactions, high evasion and arrears, and growth of the informal economy. The organizational structure of the State Revenue Service was improved to integrate tax, customs, and social security collections and to create strong internal control and anticorruption functions. The Vigilance Unit, operating independently of the financial police, was to:

- Monitor and educate staff based on a code of ethics.
- Investigate cases of illicit enrichment.
- Conduct disciplinary proceedings.
- Develop guidelines for managers dealing with corruption.
- Redesign business processes to reduce discretion and, where discretion must be retained, establish systems to monitor its exercise.
- Develop incentives to foster integrity and good conduct.
- Monitor declarations of income and assets by parliamentarians, ministers, and public servants.

Guatemala decided to merge its tax and customs agencies into one autonomous agency. All agency staff were replaced or had to reapply for their positions, a process that was contracted to private recruitment firms and a local university. Transparency and objectivity were critical, as there was widespread public distrust and a perception of pervasive corruption in the previous tax and customs agencies. In addition, an integrated financial management system, piloted in the Ministry of Finance, is being deployed in the new tax agency, and procedures have been streamlined in tandem with process reengineering. Finally, a public information campaign is being undertaken to publicize the agency's progress in improving customer service and meeting revenue targets.

Tanzania took a tough stance against corruption by forming the Tax Revenue Administration in 1996. From its inception the administration had a reputation for being tough on corruption. A national report on corruption led to an action plan to combat it monitored by the administration's board, where an Oversight Committee on Integrity was established. In a parallel effort, an internal investigation unit was set up in the Internal Audit Department. Finally, a media campaign was mounted, supported by telephone hotlines and provisions for paying informants reporting tax evasion.

Learning from experience

Given the emerging knowledge about designing and implementing anticorruption strategies, it is vital to elicit lessons from operations like those described above. To facilitate this, the Latvia, Guatemala, and Tanzania loans have carefully specified

TABLE 1 ANTICORRUPTION COMPONENTS OF BANK OPERATIONS

	Latvia State Revenue Service Modernization Project	*Guatemala Tax Administration Technical Assistance Loan*	*Tanzania Tax Administration Project*
Addressing motive			
Basic motivation	M1, M2	M1, M2	
Positive incentives	M5	M3, M5, M7	
Negative incentives	M9, M10	M10	M9
Supply-side elements	M13		M12
Addressing opportunity			
Tax structure reforms	O2, O3	O1–O3	O1–O3
Organization and management	O4–O6, O8, O9	O4–O6, O8–O10	O4, O5, O9
Internal and external checks	O11, O14	O11	O14

Note: See boxes 1 and 2 for definitions of the codes in the table.

performance indicators for use in interim and post-project assessments. Lessons for which there is already evidence include the importance of high-level political commitment, good pre-project diagnostic work, participatory project design, and strong data recording ability. There is also evidence on the effectiveness of computerization combined with personnel, organizational, and managerial reform, and the ineffectiveness of computerization without institutional strengthening.

Several lessons have emerged on what works, but more work is needed

Important questions from current operations include:

- How important is it to embed anticorruption programs for revenue administration within larger national programs?
- Do tax structure simplification and reform have a measurable effect on corruption?
- How effective is voice at curbing corruption in revenue administration?
- Which measures to curb corruption increase administrative efficiency, and which reduce it?
- Can a revenue administration in which corruption is entrenched be professionalized without replacing existing staff?
- Do projects with explicit anticorruption components do better than those with an implicit focus on corruption—for example, in business process reengineering?

Further reading

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