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## Экономика государственного сектора

CORRUPTION, COMPLEXITY  
AND TAX EVASION

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**Abstract**

Tax evasion is facilitated by corruption, and corruption is facilitated by tax complexity. This article argues and presents evidence that tax systems have become far more complex than they need to be. The growth of public sector operations over the past century was accompanied by higher and more complex taxes, higher public spending, many new government programs, and an increasing involvement by governments in the functioning of the countries' economies and in the activities of citizens. It has created a great deal of complexity in public sectors, and a fertile field for corruption, tax evasion or tax avoidance, and abuses in some government programs. The more governments relied on tax systems to pursue an increasing number of social and economic objectives, the more complex the tax systems became and the greater were the opportunities created for some taxpayers to get around the system. Complexity also encourages the growing army of lobbyists to push for small tax changes advantageous to their clients, causing tax systems to become increasingly more complex. In addition, it increases the costs of administering tax systems and of complying with the many tax obligations. To what extent tax systems have become fertile for corruption and tax evasion is likely to depend on cultural characteristics of countries among other factors. Globalization has opened new doors and new opportunities for individuals and corporations who operate, or can operate, globally to exploit the new tax-avoiding possibilities created by globalization and a global financial system. Nevertheless, complexity is not inevitable. It could, however, be reduced, as the experience of some countries has shown.

**Keywords:** corruption, complexity, evasion, simplicity, revenue losses, equity, development.

**JEL:** D73, H20, H26.

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## Introduction

**C**orruption is an old human activity and references to it go back thousands of years. In the distant past, corruption had not always been considered an illegitimate or undesirable activity, and some modern societies continue to be relatively indifferent to, or at least more tolerant of, corruption than others. During the high days of the Roman Republic, when a modern legal system started to be created, corruption came to be seen as an undesirable and illegitimate activity. Centuries later Dante, the great Italian medieval poet, in his literary masterpiece *Inferno*, placed corrupt people in the deepest and most painful levels of Hell. The term comes from the Latin verb “to break”, because it is assumed that corruption breaks some widely accepted norms. The term entered the English language at about Dante’s time, in the 13th–14th centuries. A few centuries later, the US Constitution made corruption, together with treason, one of the two explicitly mentioned crimes that could lead to the impeachment of a president.

Over the years, there have been different definitions of corruption, some more morally based and some more legally based. The concept of corruption, defined as *the act of breaking an accepted social or legal norm*, must inevitably recognize that different societies may respect different norms, and that some norms are not legally defined. Therefore, an act that may be considered corrupt in one society may be seen as normal, expected, and tolerated in another. This is especially the case when the act reflects relations with, or assistance provided to, friends, family members, or other members of close communities. In some societies, for example, exchanges of favors, which may hide bribes, are considered normal. As a consequence, some forms of corruption take the form of, or start as, favors [Tanzi, 1995a].

In recent years, there has been the problem of the rise of what could be called *legally tolerated corruption*, that is, behavior that many may consider questionable, or even illegitimate, but that is not explicitly forbidden by a specific law or regulation. Examples of legal corruption have come from the financial market, from some forms of tax avoidance, and, in some mineral-exporting poor countries, from some questionable acts on the part of policy-makers.

The role which culture plays in human relations is important in understanding why corruption continues to be more common in some parts of the world than in others [Tanzi, 1995a]. For this reason, much time was spent in defining corruption in international meetings during the decade of the 1990s, when corruption became a significant global issue due to globalization. At that time, it had become necessary for lawyers from international organizations and from countries’ governments to agree on a legally and widely agreed definition of corruption. That definition would apply to all actors operating in a world that was becoming progressively more globalized, when multinational enterprises and individuals were increasingly operating in places that had different cultures and legal systems.

*Tax evasion* is a slightly more recent sin or activity than corruption. The term also first appeared in the late Middle Ages and was linked with the taxing activity of the governments of “city-states”. It refers to illegitimate actions on the part of taxpayers directed at evading the payment of due taxes. A modern day visitor to Venice can still see, at the entrance of the Doge’s Palace at Piazza San Marco, an old, carved stone that, centuries ago, had invited Venetian citizens to report those who were hiding corrupt or taxable activities from the Republic of Venice.

Both corruption and tax evasion, however defined, are therefore not just modern activities. For many centuries, they have generally not been condoned. Some experts have, at times, tried to justify them on various grounds, generally related to presumably bad laws and to the bad behavior of governments and policy-makers. Some have argued that oppressive taxes and rigid regulations may lead to and justify tax- or regulation-evading reactions by citizens. Very low wages may also justify some acceptance of bribes, and regulations that are too strict may justify ignoring them.

As government activities grew over the years, and as they required higher tax revenue, more public spending and more government regulations, both corruption and tax evasion seemed to grow and to become more widespread. Tax evasion had attracted some attention of economists for some time but, until the decade of the 1990s, corruption had attracted less attention of theirs. Until that time, references to corruption had come mainly from political scientists and historians (see [Massie, 1980. P. 781–789]), or even from opera composers—see Puccini’s *Manon Lescaut* and *Tosca*—not from economists. However, since the early 1990s corruption has been receiving much more attention from economists than in earlier years ([Governance.., 2002]).

This article discusses reasons for these developments. It argues that they are likely to rest on both the growing public activities of governments and, especially, the growing complexity of modern government operations including those in tax systems.

## 1. On Tax Evasion and Corruption

After World War II, there were two major developments, worldwide, that called for higher tax revenue in both rich and poor countries. Rich countries were abandoning the more *laissez-faire*, or low government spending, policies of the past, and started on a path that would transform many of them, within a couple decades, into modern welfare states. Or, at least, they would create new and expensive government programs, even in countries that would not become classic welfare states, for example the US, Australia and some others.

To finance the higher public spending, the rich countries’ governments needed additional revenue. The needed resources came, first, from a greater use of income taxes and from many assorted small taxes; successively,

they increasingly came from the newly introduced value added taxes, or from some other general sales taxes. Income taxes and value added taxes became the two major contributors, in the second half of the 20th century, to the rise in tax revenue in industrial countries. These two taxes explain much of the rise in tax revenue.

During the 20th century, the average tax level in the industrialized countries increased, from around 10 percent of GDP at the beginning of the century to over 30 percent of GDP by the end of the century. In several European countries, the tax level even came to exceed 40 percent of GDP. In most OECD countries, the growth in tax levels came to a stop in the new millennium. More recently pressures have built up, pushing for tax reductions in several countries.

After World War II, many poor, developing countries came out of their former colonial status and became politically independent. Their governments were soon confronted by statistical evidence, made available mostly by the statistical offices of the United Nations and the newly created Bretton Woods institutions (the World Bank and the IMF), which quantified the rather obvious conclusions that these countries were much poorer than the rich countries. Therefore, they badly needed to adopt policies that would make their economies grow, to begin a process of convergence with the rich countries' living standards.

*Development economics* had then become an important field of economics, and many development economists had concluded that the governments of the developing countries should play a leading role in the economic development of those countries. At that time there was a lot of confidence in what good governments could do for their economies. Most economists were convinced that economic growth could not be expected to originate spontaneously from the actions of private sectors which, at that time, were far from modern.

The development strategy recommended by many economists was as follows: (a) the developing countries needed to accumulate more capital; (b) the governments had to raise the countries' tax burdens, to have more resources available; (c) they should keep government *current* spending low; and (d) they should use the budget surpluses thus generated to build badly needed public infrastructure and to accumulate capital in other ways.

At that time, popular economists' models (Harrod- and Domar-type models) considered capital accumulation as the key ingredient to generate economic growth. The *capital-output ratios* and the *tax levels* became the two development statistics that attracted much attention, and taxation was seen as central in the promotion of economic development. Most developing countries were urged to increase their tax levels with appropriate tax reforms and with foreign technical assistance. Foreign aid could add to governments' available resources.

Econometrically based estimates of the *tax potential* of countries became important policy inputs. Tax rates were pushed up and new taxes

were introduced, to raise the tax levels. However, because of tax evasion (and the opposition to high taxes by those citizens who had greater taxable capacity and more political power), assisted or facilitated by corrupt tax administrations, tax revenue generally increased to a far lesser extent than hoped for. Corruption also entered into investment decisions, making capital less productive [Tanzi, Davoodi, 1998].

## 2. Factors Contributing to Tax Evasion and Corruption

Some real world examples of tax evasion, in particular developing countries, may help give a feel of the importance of the problem. Examples from two important Latin American countries, Argentina and Peru, will be used (they are borrowed from two books: [Tanzi, 2007a. P. 30–33] and [Tanzi, 2010. Ch. 8]). Similar examples could have been taken from Asian countries.

In Argentina, by 1975–76, the share of tax revenue in GDP had fallen sharply, to well below the already low level which it had averaged in the preceding years. Several factors, relevant to our discussion, had contributed to that fall. At that time the role of high and increasing inflation, combined with delays in the payment of due taxes to the governments, in reducing real tax revenue was also at play. That particular factor, which came to be described in the economic literature as the “Tanzi effect”, will be ignored in the discussion that follows, because it is not relevant in these non-inflationary times [Tanzi, 1977].

Of note first, the tax administration of Argentina

had become a relaxed place where many employees received full-time (though much compressed real) salaries but worked for only few hours a day. Many... had private practices where they spent much of their working day advising the same taxpayers they were supposed to be administering [in their official jobs], on how to reduce their tax liabilities. Some were corrupt and, for a bribe, would take care of the tax problems of particular taxpayers. They would use their power in the selections of audits, in the determination of fines, in the intentional misplacing of relevant files, in selecting taxpayers for inspections, in estimating the incomes or the sales of taxpayers and so on. Some... would accommodate requests from politicians to go easy on some taxpayers. ...As one employee put it: you interpret the law for friends and apply it rigidly for others [Tanzi, 2007a. P. 31].

The above paragraph conveys much information on factors that can contribute to tax evasion, and on the role of corruption and other factors to encourage, facilitate or make possible tax evasion. The cited volume on Argentina also contains information on strategies that taxpayers used to evade taxes (faking invoices, not reporting incomes, and so on), in an economy that was still closed and where *global tax evasion* was not yet playing the major role that it would come to play in many countries in later years [Tanzi, 2007a. P. 32–33]. One exception was the actions of some rich Argentines who deposited their money in US banks where, as deposits made by “non-resident aliens”, the interest earned on the money deposited was not taxed by the US government and was not reported to the

Argentine tax administration. In those years, tens of billions of US dollars belonging to Argentine citizens were deposited in US banks.

In the Peruvian case [Tanzi, 2010. Ch. 8], Alberto Fujimori, a shy agricultural economist of Japanese background, who in a surprising election was elected president of Peru in 1990, invited the IMF to assist his country with the collection of taxes. At that time the tax level in Peru had fallen to about 7 percent of the country's GDP, and Peru was in arrears with the payment of salaries to public employees and with the servicing of its foreign debts. The main reason for the drastic revenue fall was that the tax administration had become totally dysfunctional and corrupt, during the years of the leftist populist government of Alan Garcia.

The tax mission which the IMF sent to Peru to study the problem, after a few days of work, reached the conclusion that the Peruvian tax administration was just too corrupt to be reformed. Drastic surgery was needed. As this conclusion has been described:

It was necessary to shut down the existing tax administration, sending home most of its employees, and to create a new one from scratch. The new administration would have a salary structure comparable with that of the Central Bank, but the new employees would not enjoy tenure in their jobs. They could be fired at any sign of corruption, or of incompetence [Tanzi, 2010. P. 94].

A new administration, staffed mainly with carefully selected recent college graduates, was created. "Within a short time, the situation began improving significantly, [tax revenue went up], and the new administration ... was able to move into a new building" [Tanzi, 2010. P. 95]. An incentive system was created that allowed the tax administration to keep a certain share of the total revenue collected, to allow it to pay bonuses for top performers. Some of the managers of the new tax administration came from the central bank.

The above descriptions of specific experiences of two Latin American countries make it possible to identify and to comment on factors that play, or can play, important roles in the tax evasion of most countries. Some of these factors are:

1. *The role of administrative controls.* All public institutions need some effective controls to operate efficiently. There is no "invisible hand" that could make them operate without controls. In institutions with weak or no controls, the employees spend less hours working than the official office hours suggest that they should. Furthermore, while at work, many work at a slow pace. Extended coffee breaks, frequent visits to restrooms, long lunches, and frequent absences from the offices because of faked illness or other excuses, and, while in the offices, trivial conversations with colleagues and other actions can take a toll on efficiency and productivity.

2. *Inefficiency and absenteeism,* which inevitably affect performance. Recently in Italy there have been many reported cases of employees who checked in to their offices in the morning and, as in Argentina in the 1970s,



disappeared for a good part of the day. *Job tenure* had made it difficult for the government to fire those who got caught. In some cases employees had established reciprocal arrangements with colleagues, who would electronically “card in” their arrival.

3. *The “presence” of “ghost workers”*—workers who receive salaries but never show up for work or may not even exist. Poor accountability, political corruption, and slack controls make possible the payment of salaries to *virtual* employees. In both of the above-described situations the need for controls *internal* to the institutions, and also for controls by *external* government-wide institutions (such as general accountability offices, or courts of accounts) are important. In recent years, in several countries, this issue has attracted more attention than in the past.

4. *Salary levels*. This factor has received empirical support in some studies. When salaries are low, there may be a greater temptation (or even need) for some employees to accept bribes or to engage in other illegitimate activities that generate some incomes to them. This had happened in both Argentina and Peru. Low salaries, combined with job tenure, are factors likely to create bad incentives.

5. *Government salaries kept low*, on the very assumption that the workers are receiving bribes that increase their incomes. The reasoning is that because of the bribes the government does not need to pay higher salaries. This attitude ends up legitimizing corruption and justifying the acceptance of bribes.

6. *A salary structure* that prevents some necessary and justified differentiations in salaries, between individuals with greater ability, initiative and responsibilities than others. When the salary structures become too flat, they are likely to lead to poorer performances and to other difficulties, especially when the better trained and the top performers have the option of quitting and working for private and often foreign corporations at higher salaries. This drainage of talent has become a more common problem in recent years in many developing countries, because globalization has brought potential foreign employers to those countries.

7. *The impact of rigid job tenure*. When individuals cannot be fired, at times even for incompetence or for some corrupt acts, job tenure ends up encouraging those acts. Labor unions generally defend job tenure, and some job security for public employees is important to prevent politically motivated or abusive firing. In recent years, some countries have traded the freedom to fire unproductive or corrupt workers against higher salaries, as Peru did in the 1990s.

8. *The cultural dimension*. It was mentioned in the introduction above that *corruption has a cultural dimension*. In some forms, as with the exchange of favors or with the assistance to relatives, corruption is more condoned in some cultures than in others [Tanzi, 1995a]. For this reason it may tend to be a greater problem at the subnational government level, because of the greater proximity to each other of individuals who know one another or



who are related. Corruption can also take forms that are more difficult to notice. For example, how quickly, or how favorably, an employee responds to a request from a citizen who needs a particular government authorization may depend on personal connections with that citizen.

9. *The role of contagion.* Corruption may be more contagious in some cultures than in others. When some employees engage in corrupt acts, others may be more likely to denounce them or, conversely, to imitate them. This may depend on cultures and possibly on tradition. Therefore, specific rules and active controls against some actions may be more necessary in some countries than in others.

10. Some economists have ignored or removed the cultural or moral element from acts of corruption or other crimes and have described individual decisions on whether or not to commit a crime as depending mainly on *the probabilities of getting caught and on the expected penalties expected* if caught (see [Allingham, Sandmo, 1972; Becker, 1968]; see also [Chalfin, McCrary, 2017] for a review of related literature). While the above factors are clearly important, the moral attitude of individuals vis-a-vis some illegitimate or illegal actions must also play a role and should not be removed from these decisions.

11. *Unnecessary discretion in some actions*, such as the choice by tax administrators in the selection of taxpayers for audits, in the determination of the size of some fines, in the granting of tax incentives, and so on. Discretion in some actions can encourage acts of corruption. The granting of incentives has been a problem in several countries, especially in Asia. Discretion should be limited, and administrative decisions should be based, as much as possible, on specific and precise rules. When that is not possible, there should be more strict ex-post controls. However, total absence of discretion may not be desirable and might create other problems, because some situations require judgment and discretion.

12. *Relations between tax administration and politicians.* Political influence on tax administrations remains a major problem in many countries, especially in developing countries. The insulation of tax administrators from the interference of politicians is thus essential to prevent corruption and tax evasion. There has been a lot of attention over the years to the need for the political independence of central banks, but not enough to the need for the political independence of tax administrations.

13. The *absence of incentives*, in addition to the general level of salaries, for encouraging efficient performances of employees. The criteria for hiring, promotions and salary increases are obviously important. Policies that end up rewarding good and bad performances equally are more likely to lead to corruption.

14. *The appointment* in high-level administrative positions of *politically connected individuals* with the power to channel to themselves the handling of some corrupt, but politically supported, acts. This happened in Peru in the later years of the Fujimori administration, when a corrupt colonel was appointed

as a deputy head of the tax administration. Political acts of corruption were channeled through this individual. In time, they created new great difficulties for the Fujimori government and for Fujimori himself [Tanzi, 2000. P. 120].

15. Finally, in some countries *corrupt policy-makers*, who may take actions, especially connected with the export of mineral resources or the granting of attractive tax incentives to foreign corporations that benefit the policy-makers and not the countries overall. The media have reported on some of these cases in particular countries. This form of political corruption is more difficult to deal with because corruption has become, in some sense, legal.

The above list is long, but it is probably not complete. The importance of the abovementioned factors is likely to vary from country to country. Therefore, they should not be given equal weight when assessing their importance in the incidence of corruption and tax evasion in different countries. Not all of these factors have received the attention by economists that they merit. They largely describe institutional weaknesses. Many institutional quality indexes now available from the World Bank and from other institutions show significant correlation between economic growth and those indexes. One of them is control of corruption.

### 3. On Tax Complexity and Its Impact

There is now a lot of anecdotal evidence that indicates that corruption in tax administrations, and tax evasion and tax avoidance by taxpayers are facilitated by the *complexity* that has come to characterize tax systems and, to some extent, tax administrations in recent decades. Some tax systems have become so complex that few individuals can find their way in that obscure jungle that has been created by thousands of pages of tax laws and tax regulations [Tanzi, 2013].

As a general topic for analysis and research, complexity has been attracting increasing attention among scientists, among experts in particular areas, and among economists (see, *inter alia*, [Casti, 1994; Cohen, Stewart, 1994; Heyndels, Smolders, 1995; Mitchell, 2009; Tanzi, 2007b; Waldrop, 1992; Walpole, 2015; Weaver, 1948; Weinberg, 2001; Wilson, 1999]). As Edward O. Wilson put it, “[c]omplexity theory was born in the 1970s, gathered momentum in the 1980s, and was enveloped in controversy by the mid-1990s” [Wilson, 1999. P. 96].

Mechanical, biological, ecological, social, or government systems can be *simple*, *complicated* or *complex*. The working of a simple system is easy to understand and its results are generally predictable. *Complication* is the inevitable consequence of pursuing technically difficult tasks, such as going to the Moon, producing an atomic power plant, or building a modern jetliner or smartphone. The system can be made less complicated by reducing the number of parts, but this is often not possible. *Complicated systems* need

many parts, and each part (say, a battery) has some potential to fail, thus exposing the whole system to potential disasters [Tanzi, 2007]. However, the failures are specific and attributable to the parts. Apart from them, the internal working of a complicated system should be understandable to the experts who have built it, and its functioning should be predictable by them. It should not be subject to randomness except the occasional failure of a part.

A *complex system* is, in some essential ways, different from a *complicated* one. Complexity implies that a system is hard to understand and to deal with. It may also be less stable. As Edward O. Wilson again put it, “[t]he greatest challenge today, not just in cell biology and ecology but in all science, is the accurate and complete description of complex systems” [Wilson, 1999. P. 96]. When a system is *complex*, and not just complicated, its internal working and the way its parts are related to one another become less predictable, thus raising great and, in the view of some scientists, impossible to meet challenges to science.

As noted above, some technical systems inevitably need to be complicated, such as modern jetliners or those required to go to the Moon or to other planets. They require the inputs of highly trained specialists and very precisely calibrated mechanical parts. Some systems, however, such as biological or ecological systems—and some government systems such as tax systems—can be either complicated or complex. In some of these systems, the mechanical parts are replaced by a human element, and humans can be inefficient, corrupt and irrational. When systems become complex, they become less understandable and, especially, less predictable in their workings and in their consequences.

In recent decades, the tax systems of many countries have clearly become complex, leading to the questions of whether complexity is a necessary evil for them or whether it could have been largely avoided by different tax designs [Walpole, 2015]. The tax systems of some countries have become so complex that, in some actual experiments, requests for clarifications or advice on how to deal with a specific tax issue directed to different tax offices *of the same tax administration* have received widely different replies. Furthermore, rather than interpreting some tax laws and running the risk of making serious and punishable mistakes, many taxpayers now prefer to pay tax advisers to prepare their tax returns. Assistance in tax preparation has become a big business in several countries. The greater the complexity, the greater the tax assistance business has become.

Complexity is not limited to tax systems, but is a characteristic that describes many systems in which humans and not just mechanical parts play significant roles. In a forthcoming book, this author has argued that the growth of public sector operations over the past century—a growth that was accompanied by higher and more complex taxes, higher public spending, many new government programs, and an increasing involvement by governments in the functioning of the countries’ economies and in the ac-

tivities of citizens—has created a great deal of complexity in public sectors, and a fertile field for corruption, tax evasion or tax avoidance, and abuses in some government programs [Tanzi, 2018a].

To what extent tax systems have become fertile for corruption and for tax evasion is likely to depend not only on the tax laws and on the administrative arrangements, and on how effective the controls are within the tax administrations, but also on cultural characteristics of countries. Given particular laws, administrative arrangements and controls, some cultures seem to be more likely to condone or to tolerate corruption and tax evasion than others [Tanzi, 1995a].

Complexity is often associated with the size of operations. Most human activities and institutions are more easily controllable when they are small. As they grow in size and in scope, they tend to become less controllable, and principal–agent problems grow within them. Take as a simple example the case of a small, family-owned and successful restaurant. Its success may convince its owners that it would be a good idea to expand it. They consequently rent larger premises, hire additional staff, add new dishes to the menu, and try to adjust the menu to the culinary tastes of the expanded and more diverse patronage.

The larger scale of the operation is likely to change its character and to bring difficulties that had been absent before. The incentives of the newly hired staff would be different. Principal–agent problems would be likely to develop. Some employees would be less dedicated and less responsible than those of the smaller restaurant used to be, and so on. The newly hired chefs may be less competent and may have greater difficulties satisfying the more varied tastes of the larger clientele. Organizational problems will require more controls and the adoption of clearer incentives, including greater use of penalties and rewards for the employees. In any case, uncertainty of outcome is likely to increase.

The solutions adopted to deal with the new problems are often not of a sufficient standard to cope with them because of the greater complexity that size has created. And *the greater complexity has made the outcome less predictable*. The use of franchises or corporatization along the lines of McDonald's and standardization of the product sold may reduce the difficulties and the uncertainty in some activities. In these circumstances the operation reproduces itself without adding complexity, as in a cloning operation.

Now consider tax systems and their administrations. Many years ago tax systems were simpler, and tax administrations were small. The latter had to deal with simple and often “presumptive” or “forfeit” taxes. The taxes were not based on accounting concepts but rather on cadastral values of land or buildings, on the frontage of houses, on the number of windows, on how much grain was taken to the mills to be processed, on the right to sell goods in the local market, or, simply, on the physical space that a shop occupied.

These simpler taxes which required little discretion by tax administrators were imposed on the taxpayers with *the sole objective of collecting revenue*. They largely satisfied a criterion that had been given great importance by the first Nobel Prize winner in economics Jan Tinbergen: that each policy objective should be pursued by one instrument. In the past the only objective of taxation had been *to get revenue*. Like Mao's famed tunics, the taxes used largely ignored the circumstances (or the sizes) of the individual taxpayers. Like poll taxes, "one size fitted all", because there was only one objective to satisfy—that of generating revenue. Simplicity drove the operation.

Over the last century, governments' needs for tax revenue increased and, furthermore, governments started to pursue other objectives in addition to collecting revenue. As the need for more revenue increased and the objectives pursued became progressively more numerous, new and more complex tax laws were introduced; equity and many other government objectives became important policy goals. The new taxes were increasingly based on accounting concepts (income taxes, value added taxes, wealth taxes) rather than on the presumptive or forfeit criteria of the past. New criteria were used for determining how much income tax a specific taxpayer should pay. Increasingly, the criteria took into account ability to pay, source of income, age of taxpayer, occupation, family status, size of family, use of income, and an increasingly large number of other considerations and social goals. The tax systems abandoned the Mao tunic principle and, at least in intention, attempted to fit an exquisitely tailored Armani suit to each taxpayer.

The more governments relied on tax systems to pursue an increasing number of social and economic objectives, the more complex the tax systems became and the greater were the opportunities created for some taxpayers to "game the system". The reactions of taxpayers became less predictable. Increasingly, this gaming was attempted with the assistance of "tax planners", clever tax consultants, and occasionally, in some countries, corrupt tax administrators. As a random item of information, the Italian Corte dei Conti (Accountability Office) has recently estimated that in Italy there are now about 800 different tax "incentives", presumably pursuing 800 different policy objectives through the tax system. In Brazil, the federal budget of 2016 contained thousands of objectives to be promoted by it.

In many countries, the *level* of taxation became part of the problem, but it is important to realize that it may not have been the main factor in contributing to the tax complexity. Some countries have been able to collect high levels of tax while significantly limiting the tax complexity (Denmark, Sweden and some others). They have done this by limiting special treatments, tax expenditures and many incentives and focusing on the objective of tax collection with some attention to vertical equity.

Some other countries, especially but not only Eastern European countries, introduced *flat rate income taxes* with the specific objectives of limiting complexity and the impact of higher tax rates on incentives. By so doing,

these countries abandoned the important objective of *vertical equity in taxation* and other potential objectives that many governments have considered important in today's world. The introduction of *dual income taxes* in the 1990s by the Scandinavian countries was also to some extent an attempt at keeping their tax systems from becoming more complex [Tax Policy., 1998].

Taxes can still be progressive in tax systems that are relatively simple, as in *dual income tax systems*. However those systems must retain some features of Mao tunics. They must avoid most of the special treatments connected with income sources, personal conditions, and other objectives that most governments pursue with *tax incentives, tax expenditures, tax deductions* and so on. In other words, they must ignore all or most particular conditions of taxpayers except the income level. The dual income taxes manage to do that to some extent, especially for taxes on capital incomes.

Value added taxes can also be kept simple by having a single rate applied to as broad a tax base as possible. This is the secret for administrative simplicity, and for obtaining high revenue with lower tax rates. However, in the pursuit of equity, many governments have continued to use multiple rates for different products, under the often mistaken belief that by so doing they achieve greater equity. Various empirical studies of value added taxes have shown that this is a fiscal illusion. The favorable tax treatment of what are considered "necessities" often ends up benefiting the higher income groups more than those at lower income levels. It also makes the tax system more complex and promotes tax evasion, because it is harder to keep track of the sale of specific categories of products and services than of total sales. The OECD has recently estimated that Bolivia, which uses a single VAT rate on a very broad base, collected close to 100 per cent of the tax potential while Mexico, which used multiple rates in the same period, including a zero rate for some goods and services, collected only 25 per cent of the potential [Revenue Statistics., 2014. P. 36].

The pursuit by governments of higher tax levels and especially of multiple social or economic objectives has led to complex tax systems that, in some countries, have encouraged or facilitated tax evasion and administrative corruption. Tax experts should have been more insistent in recommending that simplicity remain an important policy objective in taxation and in other social programs. It may be worthwhile to cite the views expressed over recent decades by some tax experts, on the problem of complexity in several countries, as had been reported in [Tanzi, 2013].

Writing about the problem of complexity in Australia's tax system, McKerchar [McKerchar, 2007. P. 192] stated:

The Australian federal tax system is widely regarded as one of the most complex tax systems in the world... There is... scope to inflate... claims for deductions or to exploit the ambiguities created by complex laws and instructional material.

Chris Evans and coauthors have also more recently written on the complexity of the Australian tax system [Evans et al., 2016].



On the UK tax system in 1978, J. A. Kay and Mervin A. King [Kay, King, 1978. P. 246] wrote:

No one would design such a system on purpose and nobody did. Only a historical explanation of how it came about can be offered as a justification... of how seemingly individually rational decisions can have absurd effects in aggregate.

They often result in complexity.

*The Economist* of 16 April 2005 cited a New Zealand report to ministers which concluded that the New Zealand Tax Code “instills anger, frustration, confusion, alienation”.

When Oscar Luigi Scalfaro was President of Italy he declared that the Italian tax system could only have been “designed by lunatics”. If anything, continuous tinkering and attempts to make it fairer and less exposed to evasion have made that system even more complex.

In the US, the members appointed to the Advisory Panel on Tax Reform in 2005 underlined that “[t]ax provisions favoring one activity over another or providing targeted tax benefits to a limited number of taxpayers create complexity and instability, impose large compliance costs and can lead to an inefficient use of resources”<sup>1</sup>. When the US income tax was introduced in 1913, it required 400 pages of laws and regulations. At that time some members of the US Supreme Court, which had to approve the new law, had already criticized it for its complexity. During the first 25 years of its existence the number of pages grew to 504. However, by 2006 the law and related regulations had reached the extraordinary number of 66,498 pages [Edwards, 2006]. In recent years the number of pages has continued to grow at a rapid pace. Inevitably, complexity creates space for corruption and opportunities for tax evasion and tax avoidance. It also encourages the growing army of lobbyists to push for small tax changes advantageous to their clients, causing tax systems to become increasingly more complex. Complexity increases the costs of administering tax systems and of complying with the many tax obligations. These administrative and compliance costs are important “dead weights” on countries’ economies. A useful survey of many empirical studies by Chris Evans [Evans, 2003] concluded that compliance costs can range between 2 and 10 percent of tax revenue and up to 2.5 per cent of GDP. Furthermore, they tend to be highly regressive. Additional estimates on these costs are available in [Evans et al., 2016; Tanzi, 2013]. These high compliance costs are often the direct consequence of complexity. In addition to raising compliance costs, complexity also contributes to instability, as mentioned in the report of the President’s Advisory Council on Tax Reform (2005), and makes the impact of tax systems less predictable.

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<sup>1</sup> Statement by the members of the President’s Advisory Panel on Tax Reform, April 2005. *President’s Advisory Panel on Federal Tax Reform. Simple, Fair, and Pro-Growth: Proposals to Fix America’s Tax System*. Washington, DC, 2005, November. P. 5.



#### 4. The Global Dimension

So far the discussion in this article has ignored the impact that globalization has been having on the complexity of tax systems and on the related behavior by both governments and taxpayers in various countries. Both governments and taxpayers now operate in an open world and must take into account the possible impact (positive or negative) on them that comes from the tax systems of other countries. Countries can try to exploit the possibilities created by “tax competition” and may even engage in “tax wars”.

While in the past tax evasion and related corruption had been connected mainly to *domestic* activities (often offered by the underground economy, by informal activities, and by inefficient or corrupt tax administrations), these behaviors have now increasingly gone global, at least for important taxpayers such as corporations and “high net worth individuals” (HNWIs) [Tanzi, 2012; 2018b].

Globalization has opened new doors and new opportunities: for countries’ governments, to modify their tax systems, to better adapt them to an open world; and for individuals and corporations who operate, or can operate, globally to exploit the new tax-avoiding possibilities created by globalization and a global financial system. Some governments now attempt to export some of their tax burdens and to import to their own countries tax bases from the rest of the world. Both corporations and HNWIs attempt to reduce their tax payments by transferring profits or incomes to low or zero-tax jurisdictions and by reducing their tax bases reported in high-tax-rate countries.

In recent years globalization has been attracting growing attention, and so has its impact on tax systems. That impact has been associated with increasing tax evasion, growing tax complexity, and growing evidence of corruption or other undesirable behavior by the tax officials of some countries (see, *inter alia*, [Global Tax Fairness., 2016; Tanzi, 1995b; 2012]. In May 2016, the World Bank organized an important conference on “global tax wars”. The OECD and the IMF have also been concerned with these developments.

By facilitating increasing multicountry and global economic activities of corporations and HNWIs, globalization has made tax collection more difficult than it previously had been. It has created new opportunities for tax evasion and for tax-related corruption, and opportunities for some countries to take advantage of the existing global tax arrangements. In today’s world, multinational corporations and HNWIs operating globally must deal with, and can try to exploit, tax evasion opportunities that global economic operations offer. Governments can no longer ignore the impact that the tax systems of *other countries* can have on their own countries.

Corporations have discovered that “global chains of production” and the use of inputs (physical, financial and intellectual) obtained from other countries can offer them opportunities to use “transfer prices”, “thin capitalization”, “patent boxes”, secret or nontransparent arrangements with governments of “tax havens” or of “quasi tax havens” (e.g. Ireland, Luxembourg, the Netherlands, Switzerland, Singapore, and even the UK and the US) to reduce their global tax obligations, through tax avoidance or explicit tax evasion.

A fast-growing industry of tax advisers, accounting and law firms (such as Mossack Fonseca in Panama) and other tax “facilitators” is available and willing to provide valuable assistance to both corporations and HNWI on how to reduce their tax payments (see, *inter alia*, [Global Tax Fairness..., 2016; Murphy, 2013; Palan et al., 2010])<sup>2</sup>.

The information that, in April 2016, came from the Panama Papers confirmed and provided interesting details to what was already known. It showed that a wide and often obscure (or “shadow”) global financial system, with the assistance of many banks and other financial institutions and complicit government authorities, can offer rich individuals opportunities to hide from tax collectors a large share of their income and wealth. This is often done by creating *anonymous* corporations, which become the legal owner of much of the world’s wealth, or in various other ways (see [Zucman, 2015], for estimates of hidden wealth).

There is not space in this article to describe in detail some of the strategies that enterprises and individuals are using to evade taxes. Available estimates of global tax evasion run into the hundreds of billions of US dollars. Pogge and Mehta [Global Tax Fairness..., 2016] offer additional information and estimates of annual revenue losses to governments. A recent paper by IMF economists has estimated losses of up to USD 600 billion [Crivelli et al., 2016]. On 27 March, 2017, Oxfam reported that European banks posted at least EUR 628 million profits in tax havens where they employ nobody<sup>3</sup>. It is clear, however, that these are more educated guesses than true estimates.

One important and uncontroversial aspect of these global tax-avoiding operations is that they overwhelmingly benefit high net worth individuals and not average workers. Therefore, they must have contributed to the growing inequality in the distribution of income that has been reported in many countries in recent decades.

## Concluding Remarks

This paper has discussed *domestic* and *global* factors that, by making tax systems more complex, contribute to tax evasion and to tax-related corruption. Similar arguments could have been made regarding the global financial sys-

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<sup>2</sup> See also: Burgis T. London’s Dark Money. *Financial Times*, 2016, 14–15 May.

<sup>3</sup> Europe’s Biggest Banks Register EUR 25 Billion Profit in Tax Havens. Press release, 27 March <https://www.oxfam.org/en/pressroom/pressreleases/2017-03-27/europes-biggest-banks-register-eu25-billion-profit-tax-havens>.

tem. That system has also become too complex for anyone to fully understand. In addition to having become highly complex, the global financial system is also influenced, perhaps more than tax systems, by the irrational behavior of those who participate in it, as some recent literature has argued. To some extent, complexity has also characterized some government spending programs (see [Tanzi, 2007b; 2018a]). In important economic areas, complexity must have contributed to creating more uncertainty and more randomness in policy outcomes, raising the prospects of occasional unpleasant economic surprises, as was the financial crisis of 2007 and later years.

This article has stressed that tax systems do not necessarily need to be complex (see also [Walpole, 2015]). Their complexity is a consequence of the roles that governments have increasingly wished to play in their economies and in the lives of their citizens over the past decades. The more objectives governments try to pursue and to promote and the more they rely on tax systems to do that, the more complex tax systems become, and the more corruption, tax evasion and high compliance and administrative costs result. Thus, the pursuit of many social objectives comes with a cost that may become too high when that pursuit leads to a high level of complexity.

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