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Improving tax administration

Actual tax collections have fallen short of their potential levels in the Asia-Pacific region. An ESCAP study estimated the tax potential in the region, based on each country's economic structure, including such factors as agricultural value added, GDP per capita level and the degree of trade openness.[1] The analysis showed that actual tax collection levels were below their potential levels in 17 Asia-Pacific economies with available data. Such tax gaps are estimated to be more than 6 per cent of GDP in such countries as Afghanistan, Bangladesh, Bhutan and Maldives. To narrow the tax gap, countries could consider (a) enhancing the quality of tax administration, and (b) expanding the tax base. This policy brief focuses on tax administration.

Better tax administration contributes to higher tax revenue collection and other economic benefits by reducing tax avoidance and evasion, including by influencing people's willingness to pay taxes. For instance, in India a recent study showed that tax revenue in the state with the least effective tax administration could increase by at least 57 per cent if its tax administration efficiency were to improve to the level being observed in the country's best-performing state.[2] The benefits of effective tax administration also go beyond tax revenues. In a sample of developing economies worldwide, a study shows that better tax administration helps narrow the productivity gaps between small and large firms, as smaller companies typically face higher tax compliance costs.[3]

The quality of tax administration depends primarily on the institutional set-up of tax authorities and an economy-wide legal and regulatory framework in which tax authorities operate. As such, enhancing tax administration is possible through various means. Examples include introducing effective tax legislation, increasing the use of information technology in tax operations, adopting risk-based compliance control and training of tax officials.[4] In a recent study, the quality of tax administration was assessed through four performance areas, namely taxpayer information, filing and payment, post-filing processes and the accountability and transparency of tax authorities.[5] Meanwhile, some indicators of good tax administration include a low cost-to-collection ratio, a high actual-to-target tax revenue ratio and high filing and payment compliance rates, as well as the timeliness and quality of tax services.[6]

A new composite index is proposed in this policy brief; it measures the extent to which the institutional setting and policy environment enable tax authorities to address tax avoidance and evasion, thus enhancing the efficiency of revenue collection. The newly proposed "Tax Administration Index" can be used to examine three dimensions of tax administration: (a) institutional arrangements that grant autonomy to tax authorities; (b) core business functions that facilitate compliance risk management and use advances in technology to enhance tax collection; and (c) a legal and regulatory

Figure 1. Components of the Tax Administration Index

Source: Authors.

framework that enables tax authorities to gain access to information in order to validate taxpayers' liability. These dimensions of tax administration represent three equally weighted sub-indices of the composite index. Figure 1 shows the components of the three sub-indices.

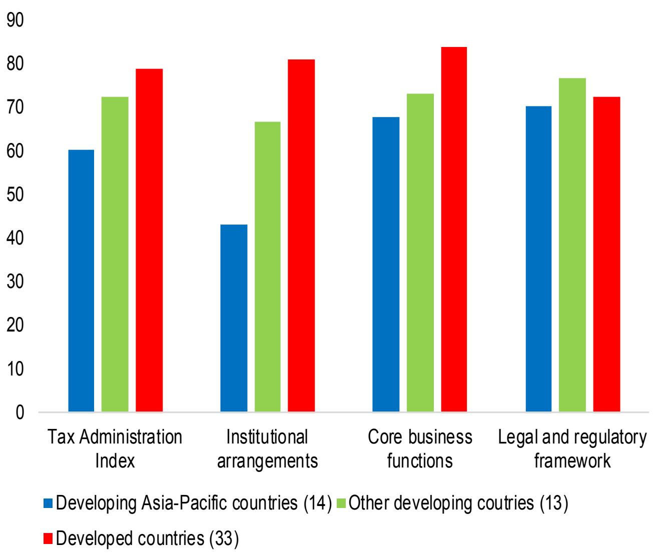
The Tax Administration Index is based largely on information obtained from surveys of tax authorities in the Asia-Pacific region and beyond.[7] These surveys focused on various aspects of tax administration, such as institutional design, budgeting, compliance risk, human resources management and use of ICT in tax operations. The newly proposed index is available for 60 economies, of which 14 are developing Asia-Pacific economies. The data period is 2015.[8]

The quality of tax administration in developing Asia-Pacific economies appears weaker than that in developed countries and developing countries in other regions of the world. Figure 2 shows that the region lags in all three sub-indices of the Tax Administration Index.

Globally, countries with better-quality tax administration tend to exhibit stronger tax collection capacity. Figure 3 depicts a positive relationship between the value of the Tax Administration Index and the tax-to-GDP ratio in 59 developed and developing economies worldwide in 2014. Interestingly, the chart also suggests that the tax-to-GDP ratios in developing Asia-Pacific economies are often lower than those in other regions of the world with a similar quality of tax administration. Among others, two possible explanations are the existence of large informal sectors in several economies in the region and the policy choice Governments make to maintain a low-tax environment in order to support the competitiveness of business sectors in such countries as Malaysia and Singapore.

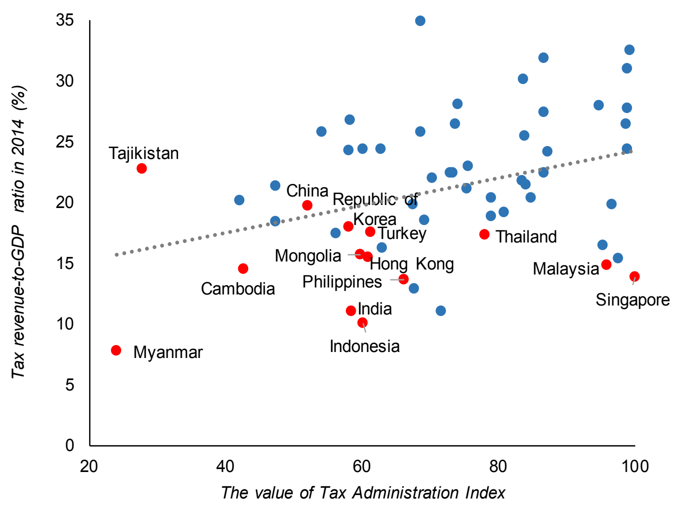
The potential revenue impact of improved tax administration is estimated to be significant. In a regression analysis that was carried out to explain the level of the tax-to-GDP ratio across countries, it was found that a one-point increase in the value of the Tax Administration Index is associated with a tax revenue increase of 0.15 per cent of GDP. To illustrate the magnitude of such a relationship, if a statutory change is made to allow tax authorities in Cambodia to design their own internal structure, this step alone could increase the value of the Tax Administration Index in Cambodia by about 11 points, so that country's tax revenue could rise by almost 1.7 per cent of its GDP. If the quality of tax administration in individual Asia-Pacific economies is assumed to match the level observed in an average OECD country, the potential increase in tax revenue could be as high as 8 per cent of GDP in Myanmar and Tajikistan, and about 3-4 per cent of GDP in larger countries, such as China, India and Indonesia (Figure 4).

Figure 2. The Tax Administration Index in developing Asia-Pacific economies and beyond



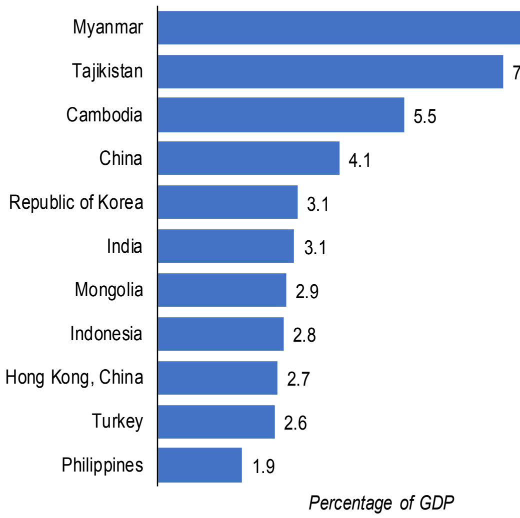
Source: Authors' calculations, based on Organisation for Economic Co-operation and Development, *Tax Administration 2017: Comparative Information on OECD and Other Advanced and Emerging Economies* (Paris, OECD Publishing, 2017); Asian Development Bank, A *Comprehensive Analysis of Tax Administration in Asia and the Pacific: 2016 edition* (Manila, 2016); and Worldwide Governance Indicators.
Note: The figures in parentheses indicate the number of countries with available data. Other developing countries are Argentina, Brazil, Bulgaria, Colombia, Costa Rica, Croatia, Cyprus, Lithuania, Malta, Morocco, Peru, Romania and South Africa.

Figure 3. Scatter plot between Tax Administration Index and tax revenue-to-GDP ratio



Source: Authors' calculations.
Note: The dots highlighted in red represent 14 developing Asia-Pacific economies.

Figure 4. Potential revenue impact of better tax administration



Source: Authors' calculations.

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[1] See United Nations, Economic and Social Commission for Asia and the Pacific, *Economic and Social Survey of Asia and the Pacific 2014: Regional Connectivity for Shared Prosperity.* Sales No. E.14.II.F.4. In addition to these factors, the actual tax levels are also closely linked to variables, such as governance, inequality and tax morale. To a large extent, the tax revenue level reflects a country's economic structure and public perception on the quality of Governments. See Richard Bird, "Taxation and development: what have we learned from fifty years of research?" Working Paper Series GSU paper 1202, (Atlanta, Georgia State University, International Center for Public Policy, 2012).

[2] Arindam Das-Gupta, Gemma Estrada, and Donghyun Park, "Measuring tax administration effectiveness and its impact on tax revenue", ERIA Discussion Paper Series ERIA-DP-2016-17 (Jakarta, Economic Research Institute for ASEAN and East Asia, 2016).

[3] Era Dabla-Norris and others, "Tax administration and firm performance: New data and evidence for emerging market and developing economies", *IMF Working Paper* WP/17/95, (Washington, D.C., International Monetary Fund, 2017).

[4] World Bank, *An integrated assessment model for tax administration: The diagnostic tool,* (Washington, D.C., 2011).

[5] Era Dabla-Norris and others, "Tax administration and firm performance: New data and evidence for emerging market and developing economies", *IMF Working Paper* WP/17/95, (Washington, D.C., International Monetary Fund, 2017).

[6] William Crandall, "Revenue Administration: Performance Measurement in Tax Administration", *IMF Technical Notes and Manuals* 10/11. (Washington, D.C, International Monetary Fund, 2010)..

[7] See Asian Development Bank, A *Comprehensive Analysis of Tax Administration in Asia and the Pacific: 2016 edition (Manila, 2016);* and Organisation for Economic Co-operation and Development, *Tax Administration 2017: Comparative Information on OECD and Other Advanced and Emerging Economies* (Paris, OECD Publishing, 2017). Since the Tax Administration Index is based on survey-based information, the index reflects the institutional setting that is in place rather than actual performance indicators of tax authorities. For example, while the presence of a large taxpayer unit is considered desirable, the Tax Administration Index does not capture the quality of such a unit in sample countries.

[8] For technical details, see Annex I in United Nations, Economic and Social Commission for Asia and the Pacific, *Economic and Social Survey of Asia and the Pacific 2018: Mobilizing finance for sustained, inclusive and sustainable economic growth.* Sales No. E.18.II.F.16.

The MPFD Policy Briefs aim at generating a forward-looking discussion among policymakers, researchers and other stakeholders to help forge political will and build a regional consensus on needed policy actions and pressing reforms. Policy Briefs are issued without formal editing. This policy brief was prepared by Athiphat Muthitacharoen (Assistant Professor, Faculty of Economics, Chulalongkorn University, Thailand) and Vatcharin Sirimaneetham (MPFD), benefitting from comments by Zheng Jian and Tientip Subhanij, under the guidance of Hamza Ali Malik. For further information on this issue, please contact Hamza Ali Malik, Director, Macroeconomic Policy and Financing for Development Division, ESCAP (escap-mpdd@un.org).

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