Although it is commonly said that the only things certain in life are death and taxes, it is unmistakable that taxes are in fact far from inevitable. Individuals do not like paying taxes, they take a variety of actions to reduce their tax liabilities, and in many occasions they get away with it. Some of these actions can be classified as tax avoidance, or the legal reduction in tax liabilities by practices that take full advantage of the tax code, such as income splitting, postponement of taxes, and tax arbitrage across income sources that face different treatment. Tax evasion consists of illegal and intentional actions taken by individuals and firms to reduce their legally due tax obligations, by underreporting incomes, sales, or wealth, by overstating deductions, exemptions, or credits, or by failing to file appropriate tax returns. For its part, government must take actions to increase compliance with the tax laws.

Tax evasion is notoriously difficult to measure. Still, there is widespread evidence that tax evasion is extensive and commonplace in nearly all countries. Its pervasiveness creates many problems for governments. The most obvious is that its presence reduces tax collections, thereby affecting taxes that compliant taxpayers face and public services that citizens receive. Evasion creates misallocations in resource use when individuals alter their behavior to lower their taxes, such as in their choices of hours to work, occupations to enter, and investments to undertake. Its presence requires that government expend resources to deter noncompliance, to detect its magnitude, and to penalize its practitioners. Noncompliance alters the distribution of

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income in unpredictable ways. Evasion may contribute to feelings of unfair treatment and disrespect for the law. It affects the accuracy of macroeconomic statistics. More broadly, it is not possible to understand the true impact of taxation without recognizing the existence of tax evasion and the economic incidence of tax evasion.

In developing and transition countries (DTCs) in particular, tax evasion is often widespread and, indeed, systemic. Thus, the problem of tax evasion tends to have far more serious consequences in DTCs than in developed economies.

In this paper I examine what we have learned from the analyses of tax evasion, which for the most part have occurred in the context of developed countries, and what we can apply from these lessons to the problem of combating tax evasion in DTCs. First, I present the basic analytical framework of the individual evasion decision, in order to study the major factors that economic theory suggests motivate individuals to evade their taxes. I argue that this basic framework offers some important insights but also suffers from some significant limitations, limitations that arise largely because of its failure to incorporate fully or realistically the role of societal institutions in the analytical framework. Second, then, I examine these institutions, and I argue that the existence of a "social norm" of compliance and the presence of an effective but service-oriented tax administration are crucial, broadly defined societal institutions that influence the magnitude of tax evasion. Indeed, these institutions are closely linked, and jointly determine the extent of tax evasion. Such institutional factors are obviously important in all countries but are especially decisive in DTCs, and, because these institutions are typically so inadequate in such countries, tax evasion is typically so extensive there. Third, I briefly demonstrate the importance of such institutions in DTCs by three case studies: in Jamaica, to demonstrate the important but limited role in developing countries of basic enforcement strategies like higher audit probabilities and penalty rates; in Africa, to demonstrate the crucial role of social norms in compliance decisions; and in Russia, to demonstrate the limited effect of administrative innovations like tax amnesty in a country that lacks both an effective tax administration and a social norm of compliance. I conclude with a discussion on how to improve tax compliance in DTCs.

THEORETICAL FOUNDATIONS OF THE COMPLIANCE DECISION

The standard economic approach to the analysis of tax compliance has relied upon the economics-of-crime methodology first applied to tax compliance by Allingham and Sandmo (1972). In its simplest form, an individual is assumed to receive a fixed amount of income I, and must choose how much of this income to declare to the tax authorities and how much to underreport. The individual pays taxes at rate t on every dollar D of income that is declared, while no taxes are paid on underreported income. However, the individual may be audited with a fixed, random probability p; if audited, then all underreported income is discovered, and the individual must pay a penalty at rate f on each dollar that he or she was supposed to pay in taxes but did not.

The individual's income I, if caught underreporting equals \( I = I_0 - D(f(1-I)) \), while if underreporting is not caught, income I, is \( I = I_0 - f(1-I) \).

The individual chooses declared income to maximize the expected utility of the evasion gamble, or

\[
E(U) = pU(c) + (1-p)U(IN)
\]

where \( E \) is the expectation operator and utility \( U(I) \) is a function only of income. This optimization generates a standard first-order condition for an interior solution; given concavity of the utility function, the second-order condition will be satisfied.

Comparative statics results are easily derived. It is straightforward to show that an increase in the probability of detection \( p \) and the penalty rate \( f \) unambiguously increase declared income. An increase in income has an ambiguous effect on declared income, an effect that depends upon the individual's attitude toward risk. Surprisingly, an increase in the tax rate \( t \) has an ambiguous effect on declared income. A higher tax rate increases the return to cheating, which reduces the amount of declared income. However, a higher tax rate also reduces income; if, as is usually assumed, the individual exhibits decreasing absolute risk aversion, then the lower income makes the evasion gamble less attractive and declared income increases accordingly.

This economics-of-crime approach gives the sensible result that compliance depends upon enforcement. However, it is essential to recognize that this approach also concludes that an individual pays taxes because - and only because - of the economic consequences of detection and punishment. Again, this is a plausible and productive insight, with the obvious implication that the government can encourage greater tax compliance by increasing the audit and the penalty rates. The many extensions of this economics-of-crime approach considerably complicate the theoretical analyses, and generally render clear-cut analytical results impossible. Nevertheless, they retain the basic approach and the basic result: individuals focus exclusively on the financial incentives of the evasion gamble, and individuals pay taxes solely because they fear detection and punishment.

However, it is clear to most observers that compliance cannot be explained entirely by such financial considerations, especially those generated by the level of enforcement. For example, the percentage of individual income tax returns that are subject to a thorough tax audit is generally quite small in most countries, often less than 1 percent of all returns. Similarly, the penalty on even fraudulent evasion seldom exceeds more than the amount of unpaid taxes, and these penalties are infrequently imposed; civil penalties on non-fraudulent evasion are even smaller. A purely economic analysis of the evasion gamble suggests that most rational individuals should either underreport income not subject to source withholding or overclaim deductions not subject to independent verification because it is extremely unlikely that such cheating will be caught and penalized. However, even in the least compliant countries evasion never rises to levels predicted by a purely economic analysis, and in fact there are often substantial numbers of individuals who apparently pay all of their taxes regardless of the financial incentives they face from the enforcement regime.

The basic model of individual compliance behavior therefore implies that rational individuals should report virtually no income. Although compliance varies significantly across countries and across taxes, and if often quite low, compliance seldom falls to a level predicted by the standard economic theory of compliance, even in DTCs. It seems implausible that government enforcement activities alone can account for these levels of compliance; the basic model, in its reliance on expected utility theory, is certainly unable to explain this behavior. Indeed, the puzzle of tax compliance behavior is why people pay taxes, not why they evade them (Alm, McClelland, and Schulze, 1992). This observation suggests that the compliance decision must be affected in ways not captured by the basic economics-of-crime approach.

In short, the limited ability to incorporate many relevant factors or to incorporate them in a meaningful way has meant that the standard theoretical analysis of the compliance decision is largely unable to explain the level of tax reporting, even when it has more success in explaining the change in reporting in response to policy innovations. In particular, these models generally imply that rational individuals should pay far less in taxes than they actually do. This is not a mere quibble. It goes to the heart of the basic model, as well as
its many extensions, for explaining compliance. Consequently, most of the theoretical analyses that economists have produced in the context of developing economies give limited help in understanding the problem of tax evasion in DTCs. As I argue next, I believe that a meaningful study of tax compliance requires recognition of the important, perhaps decisive, role of societal institutions in the tax compliance decision.

THE ROLE OF SOCIETAL INSTITUTIONS

Social Norms. A first institution is what might be termed the "social norm" of compliance. Although difficult to define precisely, a social norm can be distinguished by the feature that it is process-oriented, unlike the outcome-orientation of individual rationality (Elster, 1989). A social norm therefore represents a pattern of behavior that is judged in a similar way by others and that is sustained in part by social approval or disapproval. Consequently, if others behave according to some socially accepted mode of behavior, then the individual will behave appropriately; if others do not so behave, then the individual will respond in kind.

The existence of a social norm suggests that an individual will comply as long as he or she believes that compliance is the social norm. Conversely, if noncompliance becomes pervasive, then the social norm of compliance disappears. It is also likely, though not without controversy, that the social norm of compliance differs significantly across countries. Some evidence to support this variation in social norms is discussed in more detail later.

This perspective also suggests that, if government can affect the social norm of compliance, then such government policies represent another, potentially significant tool in government's battle with tax evaders. Of course, policies to change the social norm of compliance are difficult to determine in theory. However, there is some evidence from various social sciences that suggests that these norms can be affected by government institutions and policies.

For example, the role of process in individual and group decisions is becoming increasingly recognized. There is much behavioral science evidence that implies that greater individual participation in the decision process will foster an increased level of compliance, in part because participation implies some commitment to the institution and such commitment in turn requires behavior that is consistent with words and actions. This notion implies that one dimension by which social norms can be affected is via individual participation in the decision process, say, by voting. Also, survey evidence suggests that compliance is higher when taxpayers feel that they have a voice in the way their taxes will be spent. Under such circumstances, they are likely to feel more inclined to pay their taxes.

Another dimension by which social norms may be affected by government actions is related to the level of popular support for the government program. Widespread support tends to legitimize the public sector, and so imposes some social norm to pay taxes. Consequently, it seems likely that there will be more tax compliance when the public good provided to a community is popular. Survey evidence is consistent with this hypothesis.

Still another dimension by which social norms can be changed is the government's commitment to enforcing the tax laws. In fact, as I emphasize later, it seems likely that there is a constant interaction between social norms and tax administration. If the perception becomes widespread that the government is not willing to detect and penalize evaders, then such a perception legitimizes tax evasion. The rejection of sanctions sends a signal to each individual that others do not wish to enforce the tax laws and that tax evasion is in some sense socially acceptable, and the social norm of compliance disappears. Such an outcome is common in many countries such as the Philippines and Italy where it seems to be accepted that tax evasion is the norm. The introduction of a tax amnesty may also affect the social norm of compliance. A tax amnesty gives individuals an opportunity to pay previously unpaid back taxes without being subject to the penalties that the discovery of evasion normally brings. Such amnesties may reduce compliance if honest taxpayers resent the tax forgiveness given to tax cheats (and if individuals believe that the amnesty may be repeated again). The role of tax amnesties is discussed in more detail later. I believe that there is considerable intuitive appeal to the potential importance of social norms in tax compliance behavior. There is strong evidence that many countries with roughly the same fiscal system exhibit far different patterns of compliance. There is also much survey evidence from many countries that indicates that compliance is strongly affected by the strength and commitment to the social norm of compliance, and other survey evidence suggests that some people will not pay their taxes if they dislike the way their taxes are spent, if they feel they have no say in the decision process, if they feel that government is unresponsive to their wishes, or if they feel that they are treated unfairly by government. There is also some evidence that compliance is affected by the nature of the collective decision process, at least in democratic countries. It may well be that such sentiments play an important, perhaps a dominant role, in tax compliance.

To illustrate the ways in which a social norm might alter the analysis of the compliance decision, consider a slight modification of the earlier compliance model. As before, an individual member, now denoted i, of a larger group is assumed to receive a fixed amount of income, and must choose the amount to declare to the tax authorities. The individual pays taxes on each dollar of declared income. Undeclared income is not taxed, but the individual may be audited with some random probability, at which point a fine is imposed on each dollar of unpaid taxes. To simplify the analysis, assume that the individual chooses declared income to maximize the expected value of the evasion gamble, an approach that is implied by expected utility maximization when the individual is risk-neutral.

The expected value EVi to individual i from the choice of declared income is 

$$EV_i = 1 - p(D) - pD(1 - pD)$$

Maximization of EVi by the choice of declared income D indicates that individual i will optimally report all income if 

$$pD < 1$$

while the individual will report zero income if the inequality is reversed. The individual's decision here is therefore all-or-none: the individual reports either all income or zero income. The presence of risk-aversion modifies the all-or-none nature of individual behavior, without changing the basic comparative statics results.

There are several ways in which the role of social norms can be introduced in the model of selfinterested individual behavior. Perhaps the simplest way is suggested by Kahneman and Tversky (1979), who incorporate what they term a "reference point" as a form of social norm in prospect theory. They assume that a loss in utility occurs if individuals do not achieve some reference point, a phenomenon they call loss aversion. The social norm may be achieved by reporting all income and paying all taxes; individuals who declare less than their full income and pay less than their full taxes suffer a loss in utility.

More formally, assume that each individual i now maximizes EVi, defined as 

$$(4)EV_i = 1 - pD - pD(1 - pD) - p(1 - pD) = EV_i - p(1 - pD)$$

where EV is defined by equation (2). The individual now is assumed to suffer a psychological loss in expected income proportional to undiscovered taxes, and the coefficient y measures as a fraction of income how much individual i would pay to avoid the loss associated with each dollar of unreported
taxes. Condition (3) for compliance now becomes modified to

\[ P > \gamma \]

which still allows for the deterrent effect of audits and fines but which is more easily satisfied than condition (3) (and is more easily satisfied the larger is \( \gamma \)). Clearly, \( \gamma \) is likely to be sensitive to the social norm of tax compliance. The stronger is the social norm, the more deviant the behavior of a non-compliant individual becomes, and the more loss the individual feels. Also, \( \gamma \) is likely to be affected by the fiscal exchange.

In summary, the investigation of the impact of social norms on compliance behavior is a promising avenue of research for understanding tax evasion in DTCs. To the extent that these norms are influenced by the responsiveness of government to its citizens’ needs and the effectiveness of government institutions, including the tax administration, the scope of government policies to combat tax evasion is significantly broader than implied by the standard economic approach. It should not come as a surprise to many government officials in DTCs that controlling tax evasion will require improving overall governance and delivering value for money to taxpayers-citizens.

**Tax Administration.** A second institution is the administrative machinery of the government tax agency. The administrative dimension of taxation has long been recognized by tax administrators and practitioners in a long list of country studies, and it has frequently been flagged by economists working on tax policy in developing countries (Goode, 1981; Bird, 1989). A "tax administration" exists to ensure compliance with the tax laws, and much of the discussion of tax administration is consistent with the economics-of-crime approach discussed earlier. However, as emphasized by Bird (1989), it is helpful to view the tax administration process somewhat more broadly, as a production function in which "inputs" like personnel, materials, information, laws, and procedures are used to produce several outputs, the most important of which is government revenue, but which also includes taxpayer satisfaction, equity, and social welfare.

With these goals in mind, tax administration in DTCs emphasizes a variety of traditional measures:

- Introducing an effective audit program that identifies individuals who do not file tax returns as well as those who underreport income or overclaim deductions and credits
- Applying non-harsh penalties often and consistently
- Using source-withholding whenever possible
- Facilitating payments through the banking system
- Making use of third-party sources of information to verify reporting behavior

These inputs view the taxpayer as a potential criminal who must be deterred from cheating.

However, it is increasingly the case that administrative inputs are not limited to these traditional enforcement mechanisms. Instead, tax administrations in many developing countries are also introducing policies that emphasize the provision of taxpayer services via such things as:

- Promoting taxpayer education and developing taxpayer services to assist taxpayers in every step of their filing returns and paying taxes
- Broadcasting advertisements that link taxes with government services
- Simplifying taxes and the payment of taxes
- Promoting voluntary compliance by lowering the costs for taxpayers associated with filing their taxes
- Ensuring relative stability of the tax system
- Adopting the general principle of self-assessment
- Promoting a taxpayer - and a tax administrator - "code of ethics".

Put differently, the taxpayer is no longer seen simply as a potential criminal but as a potential client. This new approach suggests a different paradigm for tax compliance than the one that emerges from traditional analysis. These alternative paradigms are discussed in the conclusions.

**TAX COMPLIANCE IN PRACTICE: SOME COUNTRY CASE STUDIES**

I have argued that the standard economic model of evasion offers some important insights into tax evasion, but that it also suffers from some significant limitations because of its failure to incorporate realistically the role of societal institutions such as the social norm of compliance and the presence of an effective tax administration. These institutional factors are especially critical to understand tax compliance issues in DTCs. In this section I draw on other work to illustrate the importance of such institutions in DTCs. The Jamaica case study demonstrates the important but limited role in developing countries of basic enforcement strategies based only upon higher audit probability and penalty rates. The Africa case study demonstrates the crucial role of social norms in compliance decisions. The Russia case study demonstrates the limited effectiveness of isolated administrative innovations like tax amnesties in a setting that lacks both an effective tax administration and an accepted social norm of tax compliance.

**The Impact of Standard Enforcement Methods: The Case of Jamaica.**

In 1983 the Government of Jamaica instituted a comprehensive reform of the Jamaican tax system, including the individual income tax. At that time, income tax collections accounted for 28.9 percent of total government revenues and 7.6 percent of national income. Over 90 percent of these revenues were collected from employer withholding of taxes on employee wages, under a Pay-As-You-Earn (PAYE) system.

In theory, the Jamaican income tax prior to reform was broad-based, with a high and steeply progressive rate structure that rose from a marginal tax rate of 30 percent on the first $7,000 of taxable (or statutory) income to 57.5 percent on all income above $14,000. In practice, the base of the income tax was substantially reduced by a variety of legal and illegal methods. Legal methods included the provision to employees of nontaxable "allowances" (or fringe benefits); illegal methods included tax evasion via underreporting of taxable income, overclaiming of tax credits, and nonfilling of individual income tax returns. Five separate payroll taxes, payable by both workers and firms, were also imposed on approximately the same base as the individual income tax. In total, these payroll taxes were quite large, roughly half of the revenues from the income tax, and they imposed a significant, additional burden on taxpayers.

As part of the tax reform, individuals working with, and with the full cooperation of, the Revenue Board of the Government of Jamaica, collected several types of information that allowed a detailed examination of the individual income tax (as well as of the payroll taxes). One data set focused upon the responsiveness of PAYE employers to fiscal incentives (e.g., the marginal income and payroll tax rate, the audit rate, the penalty rate, and the benefit rate of the payroll program) in their choice of taxable reported income, of legally nontaxable allowances, and of illegally underreported income. This "PAYE Survey" data set allowed empirical estimation of the determinants of PAYE worker choice between reported income, evasion income, and allowance income. These estimation results are discussed in detail by Alm, Bahl, and Murray (1990).

The dependent variables in this estimation were the shares of total compensation allocated to reported, evasion, and allowance income. The explanatory variables consisted of various measures of firm size and indicators of firm sector. Importantly, the PAYE Survey
allowed construction of a number of variables that influenced the "price" of the different income types for each taxpayer, or the amount of gross compensation that must be chosen to receive one dollar of net compensation: the marginal income tax rate on reported income, the marginal penalty rate on evasion income, the marginal payroll tax rate on cash compensation, the marginal payroll tax benefit rate, and the (predicted) probability of detection. These various components were combined into a price for each type of income, and these prices were included as explanatory variables in each share equation. The equations were estimated by Tobit maximum likelihood estimation.

Some of the estimation results are summarized in Table 1. As shown in Table 1, the own-price effects were generally significant and of the expected (negative) sign, while the cross-price effects were symmetric and generally significant; that is, individuals responded predictably to changes in the tax, penalty, audit, and benefit rates. Importantly, however, the estimated tax base elasticities were quite small. The largest reported income elasticity was to a change in the marginal income tax rate (-0.19). The other reported income elasticities were even smaller. The penalty elasticity was -0.08, the payroll elasticity was 0.07, and the probability elasticity was only -0.01.

Overall, the PAYE results suggest that the enforcement regime in Jamaica, and perhaps in most developing and transition countries, is not a major deterrent to tax evasion. Relatedly, the results also suggest that very large discretionary changes in the policy variables are required to induce a significant change in taxpayer behavior; that is, even significant administrative reforms in enforcement of the tax laws are of limited use in affecting compliance decisions. Consequently, policies based upon the traditional punishment paradigm can affect compliance but only to a limited degree.

The Role of Social Norms: The Case of Southern Africa.

Reducing tax evasion is not only a matter of applying higher penalties or increasing the frequency of audits. To develop policies for the reduction of tax evasion, it is essential to understand the behavioral aspects of the tax compliance decision. If individual attitudes toward tax compliance are a function of social norms, tax enforcement policies may have to be designed specifically for the culture in which they will be applied. However, the effects of social norms on tax compliance are not well understood. This section summarizes the results of the laboratory experiments on tax compliance behavior conducted by Cummings, Martinez-Vazquez, and McKee (2001) in South Africa, Botswana, and the United States, experiments designed to examine the role of social norms in compliance decisions.

These countries differ greatly in their societal institutions, including tax administration and citizen attitudes toward government. The self-assessment and audit processes are broadly similar across the three countries; however, there are varying degrees of aggressiveness in enforcement, and the level of development and sophistication of the tax enforcement apparatus also differ across the three countries. There are also significant differences in the public perception of government, the equity of the tax system, and the penalties imposed for evasion. Overall, while the United States scores highest in government openness and equality, the tax system and the perception of the public sector in Botswana seem to be rated the highest. South Africa is rated lowest on all counts.

Cummings, Martinez-Vazquez, and McKee (2001) designed laboratory experiments to test the role of social norms in compliance. The laboratory experiments replicated most of the elements of the basic structure of the personal income tax system in the three countries. Human subjects in a controlled laboratory were told that they should feel free to make as much income as possible. At the beginning of each round of the experiment, individuals received income, and they had to decide how much income to report. They paid taxes on income voluntarily reported. They did not pay taxes on unreported income. However, they faced a penalty of audit, and, if they were detected evading, they paid a penalty on taxes not reported. This process was repeated for a given number of rounds, and at the end of the experiment each subject was paid an amount that depended upon his or her performance during the experiment. The experiments were fully computerized, and the subjects interacted with a simplified tax form on the computer screen.

Importantly, the levels of the tax rate, the probability of detection, and the penalty rate were identical across all three countries; that is, all subject pools were subjected to identical parameters in the three countries. Consequently, any observed differences in tax compliance behavior can be interpreted as motivated by differences in those institutional features that may affect attitudes toward the government (and by other possible factors that may capture differences in the social norms across the countries).

Cummings, Martinez-Vazquez, and McKee (2001) used the experimental results to estimate the factors that determine the individual compliance rate. These factors included several variables, including dummy variables for subject pools from Botswana and the United States, with the control group being South Africa. One set of estimation results is reported in Table 2. These results generally support the argument of a significant effect of social norms on compliance behavior. Controlling for different possible impacts on compliance, they found that compliance is higher in Botswana and in the U.S. than in South Africa; they also found that the compliance rate is generally higher in Botswana than in the U.S. In summary, the experimental results suggest that the observed differences in compliance behavior are closely related to societal institutions, including the perception of government behavior by taxpayers and the effectiveness of tax administration.

The Effects of Tax Amnesty: The Case of the Russian Federation.

During its entire transition period, the Russian Federation has suffered from lagging tax collections and widespread tax evasion. The Russian tax authorities have attempted to reform the tax system, but have only partially succeeded. As part of its overall fiscal program, the Russian Federation has enacted a number of tax amnesties. This practice in Russia follows the practice in many countries around the world, of introducing one or more amnesties. Tax amnesties are a controversial revenue-raising tool. Advocates of amnesties emphasize the immediate and short-run revenue impact, as individuals take advantage of the grace period to pay unpaid taxes. Advocates also argue that future tax compliance and therefore future tax revenues may increase if the amnesty induces individuals not on the tax rolls to participate, and if the amnesty is accompanied by more extensive taxpayer services, better education on taxpayer responsibilities, and, especially, stricter post-amnesty penalties for evaders and greater expenditures for enforcement. Critics contend that the actual experiences of many countries indicate that the immediate impact on revenues is almost always quite small. They also question the long-run impact of a tax amnesty. If honest taxpayers resent the special treatment of tax evaders, then their compliance may decline. Further, if individuals come to believe that the amnesty is not a one-time opportunity, then they may reduce their current compliance in anticipation of another, future amnesty.

Many of these issues have been examined, especially for state governments in the United States. The experiences there, as well as those in many other countries, suggest that amnesties are unlikely to be any kind of...
fiscal panacea, but are also unlikely to be any kind of fiscal poison. In particular, the available evidence indicates that a tax amnesty typically generates only a small amount of additional tax revenue; multiple amnesties are even less successful in generating additional revenues, and they have mild but perverse effects on voluntary compliance. Importantly, successful amnesties are accompanied by administrative changes that substantially increase post-amnesty enforcement.

These experiences suggest that the multiple Russian amnesties would be irrelevant at best and counterproductive at worst. Here I discuss some evidence from Alm, Martinez-Vazquez, and Wallace (2001) on the effects of the multiple tax amnesties enacted in the Russian Federation since 1993 on tax collections.

The first amnesty was introduced on 27 October 1993 as Presidential Decree No. 1773. This decree established an amnesty from October 27th to November 30th, 1993, and stipulated that all enterprises, organizations, and private entrepreneurs who disclosed their unpaid taxes and tax payments for 1993 and all proceeding years would not be liable for any sanctions on these unpaid liabilities. The Decree also specified that any concealed incomes discovered after November 30th would be penalized by the State Tax Service (STS) at three times the unpaid tax liability. As part of the amnesty, banks were required to provide the STS with account information. However, the design of the amnesty was flawed by the short period within which a taxpayer was allowed to disclose unpaid tax obligations, by the requirement that the liability be repaid within one month, and by a failure to allow for inadvertent or unintended mistakes. The 1993 amnesty was repealed by Presidential Decree 746 of 21 July 1995.

The next amnesty was introduced by Presidential Decree No. 65 of 19 January 1996. Under this Decree, enterprises and organizations with tax arrears were allowed to defer payments on the arrears, provided that all current payments were made in time and in full. Enterprises and organizations that were granted deferments were required to pay 50 percent of the total amount due by October 1996, with payment made via quarterly payments of 5 percent of the liability; interest penalties were imposed at an annual rate of 30 percent on unpaid amounts. This Decree was widely seen by taxpayers as too burdensome. In any event, this amnesty was continued in somewhat modified form by Presidential Decree No. 685 on 8 May 1996.

Presidential Decree No. 65 was followed roughly a year later by Budget Law 29-FZ of 26 February 1997, which established guidelines for newly granted deferments on taxes and other mandatory payments. Importantly, the Law asked that the government specify the procedures by which tax arrears were to be handled. These procedures emerged in Budget Law No. 42-FZ of 26 March 1998, and amounted to a substantial reduction in penalties on arrears.

In total, given the poor quality of tax administration in the Russian Federation, these various amnesties and related provisions were seen by tax officials as an easy and attractive way of dealing with delinquent tax liabilities, especially those of mounting tax arrears. However, the almost yearly enactment of some form of amnesty contributed to the widespread belief that amnesties would be a regular event. As suggested by international experience, a further drawback of the many amnesties was that they were not accompanied by substantive tax reform in the Russian Federation, at least until very recently (Martinez-Vazquez and Wallace, 1999). The effects of the amnesties on tax collections therefore emerged as a matter of some concern.

Alm, Martinez-Vazquez, and Wallace (2001) estimated the impact of the amnesties on these various measures of tax collections, by introducing several dummy variables to represent the impacts of the two amnesties introduced over their sample period. Their estimation results for each of the various taxes, as well as for the totals, indicated that the impact of the 1996 amnesty was negative but insignificant, while the 1997 amnesty tended to have a positive but, again, insignificant effect on revenues. These empirical results are consistent with many other studies that find the effects of amnesties to be neither destructive nor benign, and often insignificant (Alm and Beck, 1993).

CONCLUSIONS

It is clear that institutions matter everywhere, but they are especially decisive in developing and transition countries where their quality is generally lower than in developed countries. Because of the crucial role of such institutions, improving tax compliance in DTCs requires focusing primarily upon improving societal institutions.

Two especially important institutions are the social norms of tax compliance and the tax administration. My discussion of social norms and tax administration suggests that two very different paradigms can be followed in encouraging tax compliance, each with very different implications for tax compliance behavior. Under the first paradigm (the "Punishment Paradigm"), taxpayers are viewed and treated as potential criminals, and the emphasis is exclusively on repression of illegal behavior through frequent audits and stiff penalties. This has been the conventional paradigm of tax administrations through history, and it fits well the standard economic model of tax evasion based on the economic theory of crime. A second paradigm recognizes the role of enforcement, but also emphasizes the role of tax administration as a facilitator and a provider of services to taxpayer-citizens. This new paradigm for tax administration (the "Service Paradigm") fits squarely with the perspective that emphasizes the role of social norms in tax compliance; that is, government can change tax compliance by changing the social norm of tax compliance.

In fact, the most recent literature on tax administration reform for DTCs (Bird and Casanegra de Jantscher, 1992; Silvani and Baer, 1997) has emphasized the new Service Paradigm for the role of tax administration, as a facilitator and a provider of services to taxpayer-citizens. Some recent administrative reforms around the world have also embraced this new paradigm with great success. One of the best examples is provided by Singapore's tax administration reform over the last decade. The main tenet of Singapore's reform is service-oriented: the conversion from a hard-copy filing system to a paperless imaging system, the extensive use of electronic filing, a one-stop service to answer inquiries about any type of tax, the ability for filers to see the entire tax form with any corrections before it is
In sum, I believe that societal institutions are critical in understanding and in combating tax evasion in DTCs. Indeed, it would appear that it may be equally important for DTCs to strengthen the social norms of compliance as to improve and modernize a service-oriented tax administration. Consequently, a government compliance strategy based only on detection and punishment may well be a reasonable starting point for tax administration but not a good ending point. Instead, what is needed is a multi-faceted approach that emphasizes enforcement, but that also emphasizes the broad range of actual motivations that explain why people pay taxes.

References


Table 1.
The Case of Jamaica: Selected PAYE Survey Estimation Results

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<tr>
<th>Reported Income Share</th>
<th>Own-price of Reported Income</th>
<th>Cross-price of Allowance Income</th>
<th>Cross-price of Evasion Income</th>
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<tr>
<td></td>
<td>Own-price of Evasion Income</td>
<td>-1.2744*</td>
<td></td>
</tr>
</tbody>
</table>

Significant at the 0.05 level.

Table 2.
The Case of Southern Africa: Selected Experimental Results on Compliance

<table>
<thead>
<tr>
<th>Independent Variable</th>
<th>Coefficient (t-statistic)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Constant</td>
<td>0.3807* (4.548)</td>
</tr>
<tr>
<td>Age</td>
<td>0.00333 (1.674)</td>
</tr>
<tr>
<td>Occupation</td>
<td>-0.0815 (2.306)</td>
</tr>
<tr>
<td>Audit Probability</td>
<td>0.6251* (5.285)</td>
</tr>
<tr>
<td>Penalty Rate</td>
<td>0.00763 (0.481)</td>
</tr>
<tr>
<td>US State</td>
<td>0.1387* (3.448)</td>
</tr>
<tr>
<td>Botswana</td>
<td>0.1569* (6.518)</td>
</tr>
<tr>
<td>US Private</td>
<td>-0.0479 (0.797)</td>
</tr>
<tr>
<td>US HBS</td>
<td>0.2858* (7.243)</td>
</tr>
<tr>
<td>Log-likelihood</td>
<td>-1619.12*</td>
</tr>
</tbody>
</table>

Note: The dependent variable is the individual subject compliance rate. US State is a dummy variable equal to 1 if the subjects attended a state institution in the United States and 0 otherwise; US Private (US HBS) is a dummy variable equal to 1 if the subjects attended a private institution (a historically black institution in the United States) and 0 otherwise; and Botswana is a dummy variable equal to 1 if the subjects attended an institution in Botswana and 0 otherwise. Asymptotic t-statistics are in parentheses.