



Report

Domestic resource mobilisation and the transition to sustainable development

Synthesis of Asia case studies

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September 2017



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Acknowledgements

This synthesis report is based on case studies carried out by Shakira Mustapha (Bangladesh), Nyda Mukhtar (China and Pakistan), Gregory De Paepe (India and Nepal) and Roel Dom (Indonesia). We are grateful to Arif Ghauri, Dharana Nepal, David Gray and Shumaila Rifaqat for their comments on the case studies; and to Ellen Kelly, Carine Escoffier, Kathy Ford and James Cole for their comments on the case studies and this synthesis report. Stephanie Sweet peer reviewed this report. Funding for this study was provided by DFID. The views presented in this paper are those of the authors and do not necessarily represent the views of ODI or DFID.

Comments from the case study country offices noted that the data analysis throughout the paper could be brought more up to date using primary data from the relevant country authorities. However, primary data collection was beyond the scope of the study and we have largely relied on international databases to ensure comparability across case countries.

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Abbreviations

AEC	ASEAN Economic Community	LMIC	Low-middle-income countries
ASEAN	Association of Southeast Asian Nations	LTU	Large Taxpayer Units
BEPS	Base erosion and profit shifting	NBR	National Board of Revenue
DANIDA	Danish International Development Agency	ODA	Official development assistance
DFID	Department for International Development	SAARC	South Asian Association for Regional Cooperation
DRM	Domestic resource mobilisation	SARTTAC	South Asia Regional Training and Technical Assistance Center
FBR	Federal Board of Revenue	SGATAR	Study Group on Asian Tax Administration and Research
GIZ	Deutsche Gesellschaft für Internationale Zusammenarbeit	SME	Small and medium-sized enterprises
GST	Goods and services tax	SRO	Statutory Regulatory Order
ICT	Information and communication technology	TARP	Tax Administration Reform Programme
ICTD	International Centre for Tax and Development	UMIC	Upper-middle-income country
IFC	International Finance Corporation	VAT	Value Added Tax
IT	Information technology	WBG	World Bank Group
IMF	International Monetary Fund	WRLD	World Revenue Longitudinal Database
LIC	Low-income countries		

Executive summary



Key messages

- The South Asia region has the world's lowest levels of tax revenue mobilisation. Domestic revenue mobilisation in Bangladesh, India, Indonesia, Nepal and Pakistan has increased only moderately since 1990, despite significant tax reforms. All five countries compare poorly to their peers on tax mobilisation. In contrast, China's tax performance compares well with that of other countries with similar levels of income.
- Strong revenue pressures, often a consequence of macroeconomic crises, were the trigger for comprehensive tax reforms in the case study countries. While tax systems have been gradually modernised, the revenue impact of reforms has been limited by policy choices that mean tax bases remain narrow and tax administrations weak.
- Supporting improvements to tax collection in South Asia by broadening tax bases and improving tax administration capacity will mean finding ways to overcome or avoid the political obstacles to such reforms. Donors have contributed positively to tax reforms in the past, and future success will require supporting domestic commitment to reform and adapting to the local political environment.

Official development assistance on its own will be insufficient to meet the financing demands of the Sustainable Development Goals. There is therefore a renewed international focus on the role of domestic resource mobilisation in sustainable development. Historically, increases in taxation have been associated with the development of more accountable and effective institutions, and increasing levels of social expenditure. While low tax-to-GDP ratios tend to be a characteristic of poorer countries, this may be a symptom rather than the cause of underdevelopment.

This report is based on case studies of the tax performance of six Asian countries: Bangladesh, China, India, Indonesia, Nepal and Pakistan. This allows for a comparison between three relatively large and rapidly growing middle-income Asian economies (China, India and Indonesia) and three more aid-dependent low- and middle-income countries (Bangladesh, Nepal and Pakistan) – which are also major Department for International Development client countries. The key findings of this report are as follows:

- The South Asia region has the world's lowest levels of tax revenue mobilisation. Domestic revenue mobilisation in Bangladesh, India, Indonesia, Nepal and Pakistan has increased only moderately since 1990, despite significant tax reforms. All five countries compare poorly with their peers on tax mobilisation. In contrast, China's tax performance compares well with that achieved by other countries with similar levels of income.

- Strong revenue pressures, often a consequence of macroeconomic crises, were the trigger for comprehensive tax reforms in the case study countries. While tax systems have been gradually modernised, the revenue impact of reforms has been limited by policy choices that mean tax bases remain narrow and tax administrations weak.
- Supporting improvements to tax collection in South Asia by broadening tax bases and improving tax administration capacity will mean finding ways to overcome or avoid the political obstacles to such reforms. Donors have contributed positively to tax reforms in the past, and future success will require supporting domestic commitment to reform and adapting to the local political environment.

Domestic revenue mobilisation, as measured by the tax-to-GDP ratio, has increased only moderately since 1990 in five of the case countries; China is the exception. Despite major tax reforms and increases in income per capita, all five countries have tax-to-GDP ratios below the average for countries with similar levels of income, and lower tax effort (actual revenue as a proportion of estimated revenue potential). The South Asia region has the world's lowest level of tax revenue mobilisation. Of the case study countries, only China shows strong performance. Nepal's recent strong performance should be treated with cautious optimism due to the potential underestimation of GDP. India is just about keeping pace with international trends in taxation. Bangladesh, Indonesia and Pakistan are improving tax collection more slowly than their peers.

This poor record on revenue collection is explained by narrow tax bases, arising from tax policy choices, and weak tax administration. Improving tax revenue collection will thus require a combination of both broadening tax bases, by reducing tax expenditures and increasing the tax net, and strengthening the capacity of tax administration.

There have been two periods of major tax reforms across the six countries. Tax reforms in 1990s were part of the wave of market liberalisation reforms that spread across the region. The thrust of the reforms was to broaden tax bases and lower tax rates, and to replace high trade taxes with domestic taxes (sales taxes or value added tax (VAT)). The second post-2000 period of tax reforms has focused more on the modernisation of tax administration, particularly through the introduction of new information technology (IT) systems. In some countries, reforms in more recent years have also focused on strengthening direct taxation, closing loopholes on international taxation and moving towards a more service-oriented tax administration.

Fiscal pressures, often a consequence of macroeconomic crises, have been the trigger for most of the comprehensive tax reform episodes in the case study countries. In the wake of such crises in the 1990s, Bangladesh, India, Indonesia, Nepal and Pakistan all had to request multilateral support agreements with the International Monetary Fund (IMF) and the World Bank. The tax reforms they pursued were thus in line with the broader market liberalisation reforms required by international financial institutions. Throughout the 2000s, multilateral assistance continued to shape most of the comprehensive tax reforms in Bangladesh, Nepal and Pakistan. Financing was conditional on the comprehensive tax reform measures included in the support agreements. However, the effective implementation of these donor-led tax reforms depended on the extent of domestic political commitment.

Political commitment to tax reforms is shaped by the political dynamics within countries. Economic elites lobby for preferential tax treatments in the form of exemptions and incentives, undermining tax policy reforms. The patronage networks of political elites can slow down or stall governance-related tax administration reforms. The domestic stakeholders threatened by tax reforms tend to be more informed, organised and politically connected (through informal networks) than the wider public. This enables them to influence tax negotiations in their favour and at the expense of the wider public, who would otherwise benefit from tax reforms and the increased funds they would provide for public investment and service delivery.

This strong opposition by special interest groups means that successful tax reforms need to focus more on what is politically feasible than on what is economically desirable. Successfully building the capacity of tax systems in difficult institutional environments could pursue several complementary approaches, depending on the extent of domestic commitment to tax reform:

- Fostering broad-based, demand-driven domestic commitment to tax reform – a crucial prerequisite in the absence of political commitment. This requires strengthening the capacity of local actors (businesses, the media, civil society organisations), including anti-corruption measures in support programmes and a creative use of disbursement conditionalities with revenue-related triggers.
- Adapting tax reforms to the prevailing local political environment, to take advantage of existing domestic support. This requires a thorough understanding of the country's political-bureaucratic context, based on up-to-date political economy analysis, to better identify the incentives and constraints that underlie reform dynamics.
- Building more effective tax administration capacity. This inevitably calls for a long-term perspective, strong buy-in from senior management and greater regional cooperation across a range of issues.

These approaches can be mutually reinforcing, as a combination of opportunistic short-term 'quick wins' may demonstrate the value of reform and sustain support and momentum for a more substantial medium-term reform strategy.

Asia, and especially South Asia, is relatively poorly networked in terms of regional tax policy and administration. In South Asia, this is complicated by the India-Pakistan relationship. Despite this, the South Asian Association for Regional Cooperation has made some progress on tax policy matters, such as avoidance of double taxation and exchange of information, which could be supported further. South Asia also lacks a dedicated regional tax administration organisation to promote peer learning and evidence-based discussions. However, the recent establishment of the IMF South Asia Regional Training and Technical Assistance Center in Delhi provides a potential avenue for pursuing such activities – although Pakistan is not a member.

1. Introduction

The objective of this report is to help set the context for the renewed focus on domestic resource mobilisation (DRM) in development finance debates. This report synthesises the findings from six case study countries in Asia, to determine if there are lessons on the importance of DRM reforms for the transition to higher-income status and sustainable development. It examines the experiences of large, rapidly growing middle-income Asian economies (China, India and Indonesia) and the more aid-dependent low- and middle-income countries in the region (Bangladesh, Nepal and Pakistan) – which are major Department for International Development (DFID) client countries.

This introductory section sets out the rationale for the renewed interest in DRM and puts South Asia's performance into comparative perspective. Section 2 looks in more detail at tax performance in the six case countries, highlighting common areas of weakness. Section 3 provides an overview of the tax reform histories of the six countries, identifying specific periods of reform and the drivers of these reforms. Section 4 takes a political economy approach to identify the factors, actors and interests that have driven, or alternatively blocked or stalled, tax reforms. Section 5 synthesises the lessons from reform efforts in the case countries and provides guidance on how support to DRM may be applied and scaled up in the future in South Asian countries.

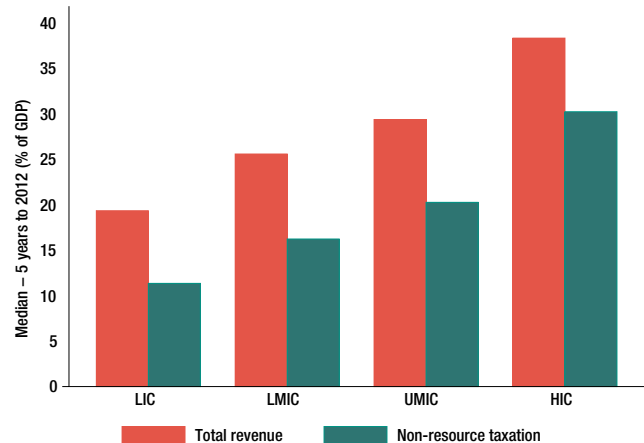
1.1. A renewed international focus on domestic resource mobilisation for sustainable development

Long and Miller (2017) note three main interlinked arguments for the renewed focus on the primacy of DRM for financing sustainable development. The first is a financing argument. Current levels of official development assistance (ODA) are insufficient to meet the ambitions of the Sustainable Development Goals (SDGs), which call for an escalation in development finance from 'billions to trillions' (World Bank and IMF, 2015). This line of argument recognises that the governments of poorer countries raise too little revenue (see Figure 1), particularly non-resource tax revenue, which constrains their ability to invest in sustainable development.

The second is a spending argument. As illustrated in Figure 2, more tax revenues tend to be associated with more social spending in areas such as health, education and social protection, and the achievement of the SDGs.

The third argument is that greater reliance on tax revenues (as opposed to other revenues) is associated

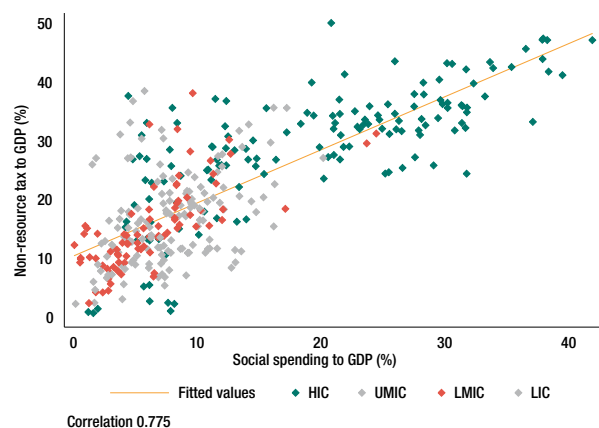
Figure 1: Poorer countries collect less tax than richer countries



Source: ICTD Revenue Database and IMF GFS.

Note: Country categories are per the World Bank income classifications for low-income countries (LIC), lower-middle-income countries (LMIC), upper-middle-income countries (UMIC) and high-income countries (HIC).

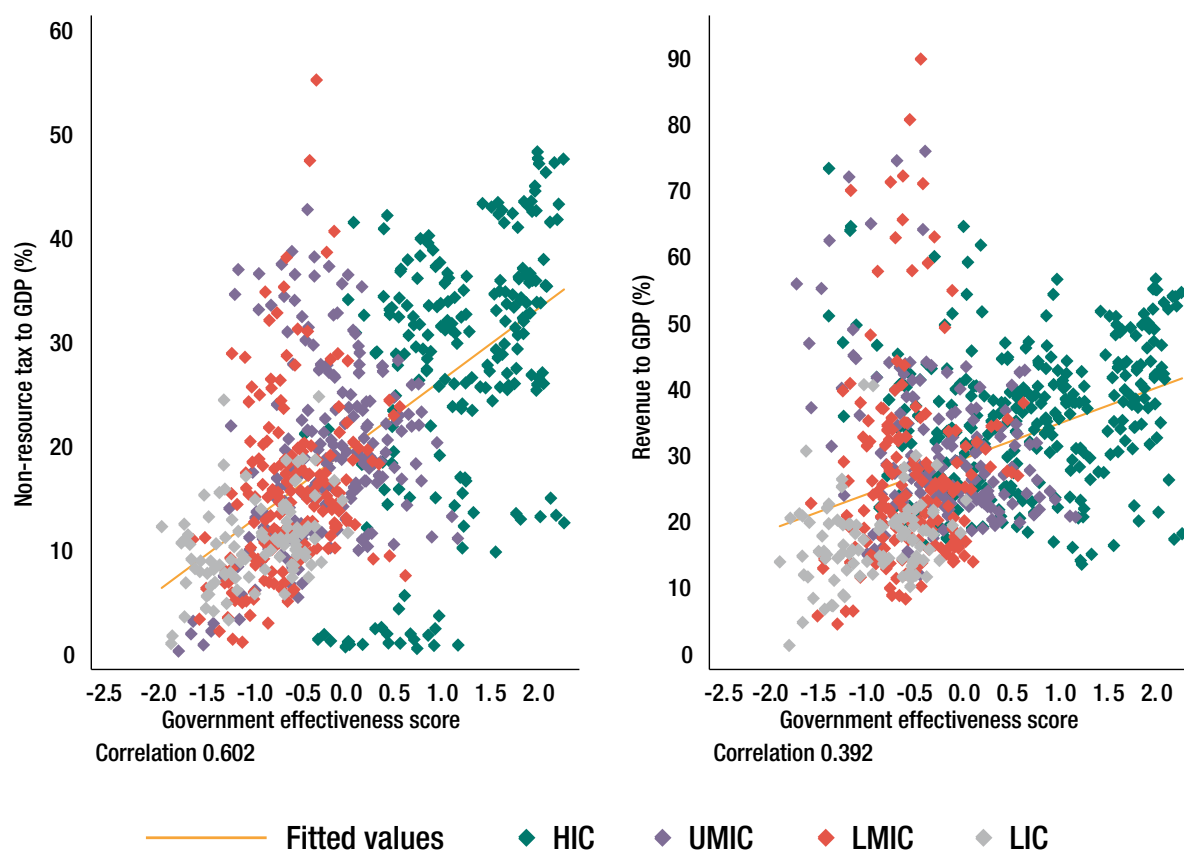
Figure 2: More taxation is associated with more social spending, 1980-2012 (10-year averages)



Source: ICTD Revenue Database, IPFRI SPEED Database.

Note: Social spending is calculated as the sum of health, education and social protection.

Figure 3: Government effectiveness is more closely associated with non-resource taxation than with revenue more generally



Source: ICTD Revenue Database, IMF GFS, World Governance Indicators

with better governance (Moore, 2007). Theoretical research argues that the need to raise taxes and encourage compliance creates incentives for governments to be responsive and accountable to citizens, while spurring taxpayers to make greater demands on governments (Prichard, 2016). Figure 3 highlights the closer association between non-resource taxation and better governance, compared with revenues more generally.

Of course, correlations should not be misconstrued as causation, nor is the direction of the relationship clear. As Besley and Persson (2014) note, ‘Poor countries are poor for certain reasons and these reasons can also help to explain their weakness in raising tax revenue’. These reasons include the following:

- Economic structure – low-income countries (LICs) tend to have large informal sectors that are administratively difficult to tax.
- Lack of government action – despite the tendency for accompanying formalisation of the economy, rising income levels do not mechanically translate into a higher tax take without some deliberate government action to modernise the tax system and provide incentives to transition into the formal economy.

- Aid and resource dependence – to the extent that such dependence diminishes the actions that would increase taxation.

It is important to note, however, that today’s LICs collect taxes at higher rates than today’s richer countries did at a similar stage of development. As such, one should be cautious in diagnosing the lack of capacity to tax as the cause rather than as a symptom of underdevelopment (Long and Miller, 2017). Nevertheless, the South Asia region does fit much of the narrative that low levels of taxation are impeding sustainable development.

1.2. Domestic revenue mobilisation in South Asia in comparative perspective

The South Asia region is the lowest performing region in the world in terms of domestic revenue mobilisation. Over the five-year period to 2014 the average revenue-to-GDP and tax-to-GDP ratios for the region were 20% and 13% respectively. While lower income can explain much of the underperformance, South Asia also significantly underperforms compared with sub-Saharan Africa, which had revenue-to-GDP and tax-to-GDP ratios of 24% and

16% respectively over the same period, despite lower income levels (see Figure 4).

South Asian lower-middle-income countries (LMICs) also tend to underperform relative to their peers in Central Asia: Tajikistan, the Kyrgyz Republic and Uzbekistan all have higher tax-to-GDP ratios than their South Asian LMIC peers (see Figure 5).

This underperformance is despite the fact that effective tax rates for medium-sized companies in the South Asian LMICs are above the world average, and higher than in LMICs in the East Asia and Pacific, and sub-Saharan Africa regions (see Figure 6).

Measures of tax effort – the ratio of actual tax collection to tax potential¹ – suggest that the South Asia region should be performing better. Tax effort in South Asia is the lowest in the world and below LMICs in other regions (see Figure 7).

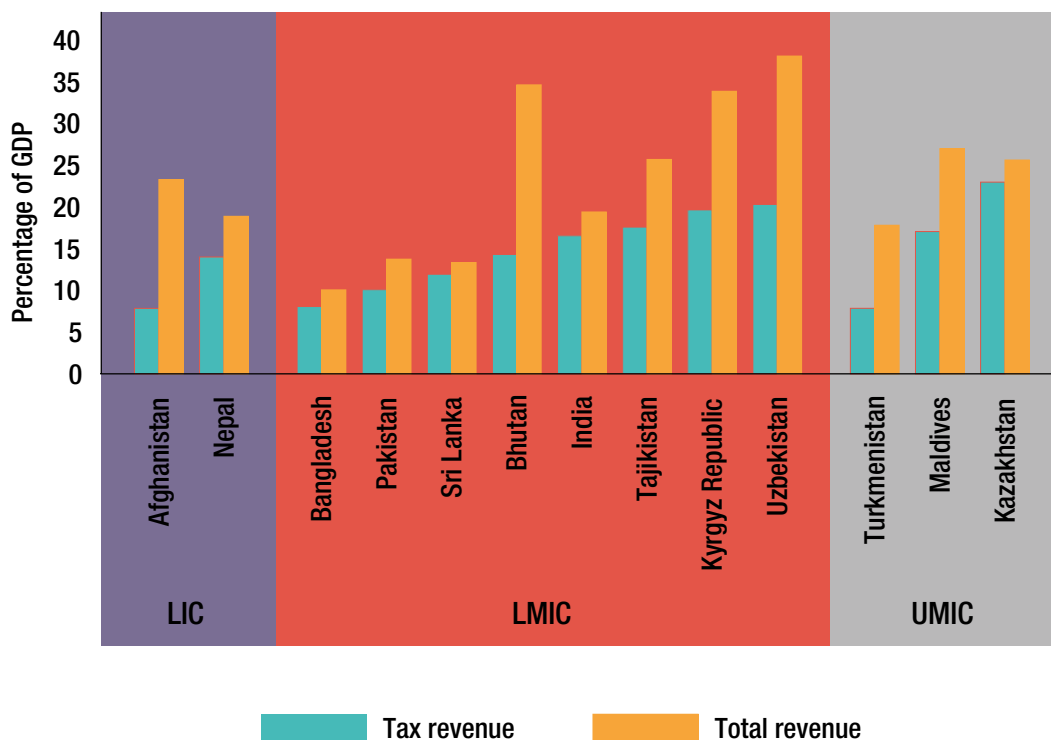
The remainder of this report seeks to more systematically explain why this is the case, before making recommendations on how South Asian countries might increase domestic resources, allowing them to move towards a more sustainable development trajectory.

Figure 4: The South Asia region has the world's lowest levels of domestic revenue mobilisation – mean, 2010-2014



Source: IMF WRLD

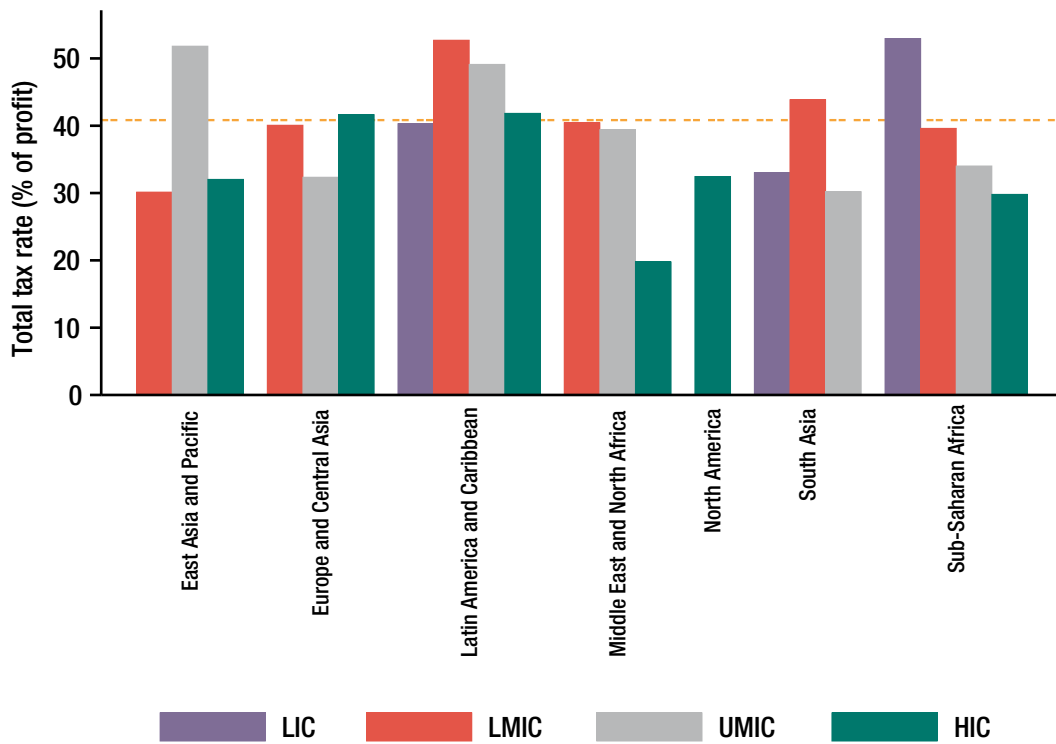
Figure 5: South Asian LMICs under perform on revenue collection compared with their Central Asian peers – mean, 2010-2014



Source: IMF World Revenue Longitudinal Database (WRLD).

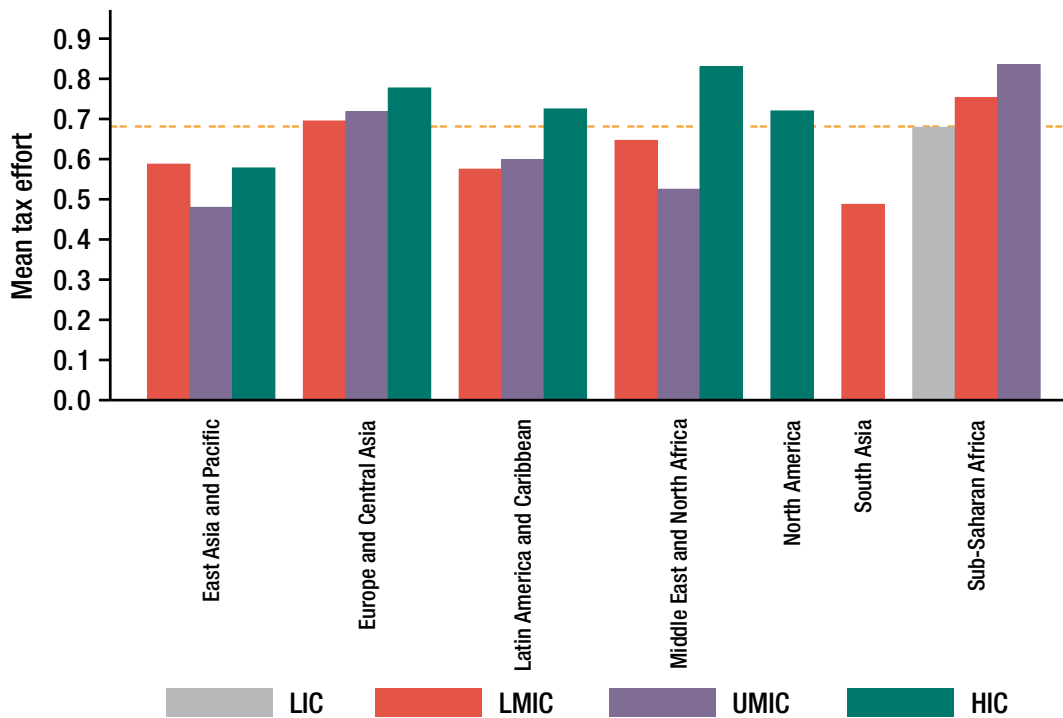
1 Tax potential is an estimate based on the economic and institutional characteristics of a country – i.e. its level of development.

Figure 6: South Asian businesses face higher tax rates compared to peer regions



Source: IMF WRLD.

Figure 7: Tax effort in South Asia is below peer regions



Source: Fenochietto and Pessino (2013). Observations range from 2010 to 2012.

2. Overview of tax performance in case countries

Key findings

- Over the past 15 years, lower- and middle-income countries have made significant strides in mobilising resources from taxation. But the same cannot be said for our case study countries – with the exception of China. Nepal’s recent strong performance should be treated with cautious optimism due to the potential underestimation of GDP. India is just about keeping pace with international trends in taxation. Bangladesh, Indonesia and Pakistan are all growing more slowly than their peers.
- Indicators of tax effort and tax productivity highlight the fact that South Asian countries are collecting taxes at rates below their potential.
- Tax revenues in Bangladesh and China are growing faster than GDP (above unity tax buoyancy ratios), meaning further economic growth should lead to increases in these countries’ tax-to-GDP ratios. In contrast, tax revenues are growing more slowly than GDP in India, Indonesia and Pakistan (below unity tax buoyancy ratios), suggesting further reforms are necessary – to ensure tax mobilisation at least keeps pace with GDP growth.
- Although indirect taxation has been the primary area of reform focus over the past 25 years, it remains an area for improvement across all case countries, with the exception of China. Like most developing countries, all the case countries are heavily reliant on indirect taxation and have significant potential for increasing direct taxation. The limited number of registered taxpayers is an immediate constraint to raising more revenue from income taxes.
- The poor tax performance of these countries to date, masks their underlying potential for increased DRM. Increased international commitment to supporting DRM and an apparent loosening in the political

gridlock blocking tax reform in Bangladesh, Nepal and Pakistan, presents an opportunity for progress. In particular, there is significant scope for improving tax systems through further administration reforms.

2.1. The recent revenue collection record of South Asian countries is underwhelming

As noted in section 1.2, South Asia is the lowest performing region in the world in terms of revenue collection. It is therefore not a surprising finding that tax collection performance in four of the six South Asian case study countries² has been underwhelming compared with their peers (see Figure 8 for tax-to-GDP trends between 1990 and 2014 for the case study countries):

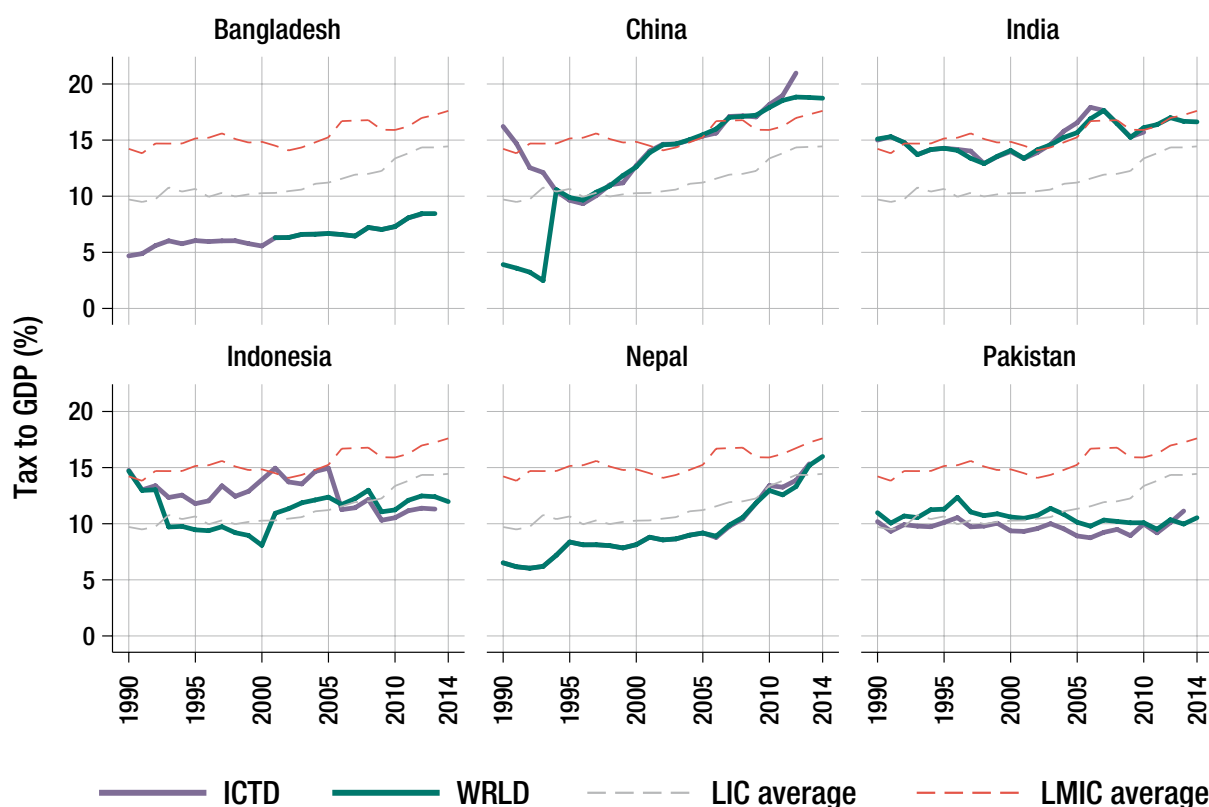
- Bangladesh’s tax-to-GDP ratio rose from under 5% to 10.5% over the period from 1990 to 2014,³ with most of the increase occurring since 2007 when the tax-to-GDP stood at just 6.5%. However, it remains one of the lowest in the world, far below the average rate for LICs, despite the fact that Bangladesh graduated to LMIC status in 2016.
- Pakistan’s current tax-to-GDP ratio also remains low (at approximately 10%) and has been stuck around this level since 1990. As a result, it has fallen below the LIC average, despite Pakistan having graduated to LMIC status in 2010.
- Nepal, which, along with conflict-affected Afghanistan, remains one of only two LICs in the South Asia region, saw its tax-to-GDP ratio rise above the LIC average in the years following the end of its civil war in 2006. For 2015/16, tax-to-GDP reached an impressive 18.7% (IMF, 2017a).⁴ While this impressive trajectory stands in stark contrast to the performance of Bangladesh and Pakistan, scepticism surrounding the accuracy of

2 The South Asian countries not included in the case studies are Afghanistan, Bhutan, Maldives and Sri Lanka.

3 Mansur (2015) for 2014 data.

4 By 2014, Nepal’s tax-to-GDP ratio had breached the 15% of GDP threshold. As noted by Gaspar et al. (2016), this is a target routinely set for LICs by the IMF.

Figure 8: Tax-to-GDP ratios are below average in case study countries



Source: IMF WRLD and ICTD Revenue Database. ICTD values are used where there are either discrepancies with or missing values in the WRLD. Averages for income groups are calculated using the WRLD.

the GDP measurement have led to questions about overestimation (ibid.).⁵

- India's tax revenue collection declined for much of the 1990s, as reforms to consumption taxes struggled to keep pace with revenue losses arising from the decline in trade taxes that followed market liberalisation. This was a common experience across developing countries (Baunsgaard and Keen, 2010). The tax-to-GDP ratio declined from a peak of 17.5% in 2007 to 15.5% in 2009 as a result of countercyclical fiscal policies introduced to help the country weather the global economic crisis. Tax revenues slowly recovered to their pre-crisis levels in 2014. In general, India's tax performance has kept pace with the broader trend for LMICs, including when reducing taxes as a fiscal stimulus during the financial crisis. While India outperformed the average for LICs prior to its graduation to LMIC status in 2009, its current performance is below average for its income status (although by regional standards it is performing relatively well).

In terms of performance, the two East Asia and Pacific case study countries stand in stark contrast to each other; they therefore do not provide much of a benchmark for the four South Asia countries. Income levels in both are significantly higher than their South Asia counterparts.

- Performance in Indonesia, which graduated to LMIC status in 2003, has failed to keep pace with the trend in tax-to-GDP ratios for countries of similar income status. Its lower tax-to-GDP ratio is complemented by resource income of approximately 20% of total revenues.
- China's performance is more impressive. Buoyed by rising income levels, its tax-to-GDP ratio has risen steadily since undertaking tax reforms in 1994 (complemented by its market liberalisation reforms). Its tax-to-GDP ratio overtook those of its LMIC peers in the middle of the last decade; it subsequently transitioned to upper-middle-income country (UMIC) status in 2012. China's 2014 tax-to-GDP ratio of 19% is in line with its current UMIC peers.

Relative tax performance across countries is reflected more accurately by tax effort measures than the ratio of

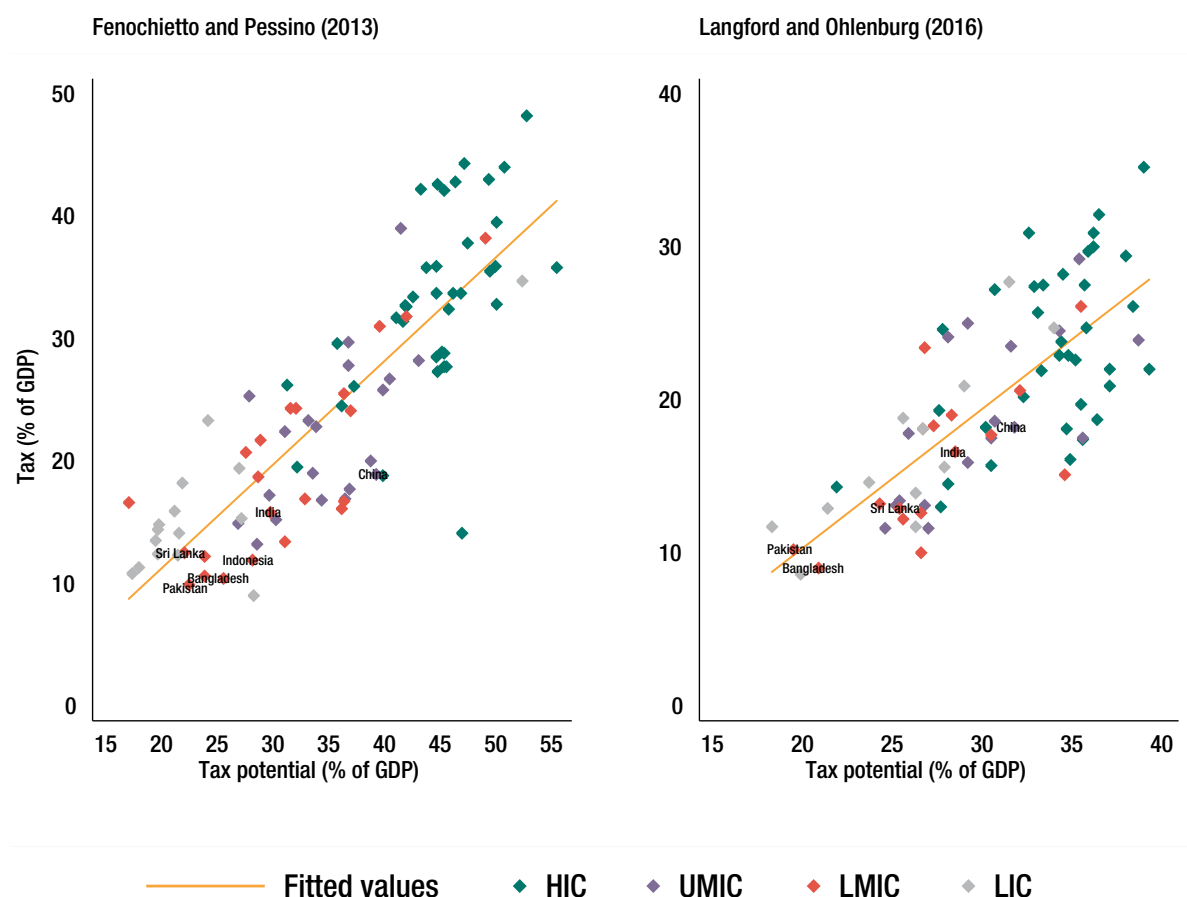
⁵ The concern is that GDP is underestimated due to out-of-date base data and methods. If GDP is underestimated then the tax-to-GDP ratio will be overestimated. Rebasings exercises in recent years in several African countries have led to significant changes in GDP estimates: Nigeria's nearly doubled; Ghana's rose by more than 60%; Tanzania's grew by a third; Kenya's and Zambia's increased by a quarter.

taxation to GDP. As illustrated in Figure 9, all countries collect below their tax potential, to a greater or lesser degree.

Tax productivity indicators – the ratio of actual tax collection to the tax rate – provide a similar narrative. Table 1 highlights the relatively poor tax productivity of

our case study countries compared with the LIC average, despite the fact that they are all (with the exception of Nepal) above this income level. Indicators of indirect tax productivity are better than those for direct tax productivity, highlighting the fact that the former has been the focus of reforms over the past 25 years (see section 3).

Figure 9: Tax collection is below potential in the case study countries



Source: Fenochietto and Pessino (2013): no data for Nepal; Sri Lanka included as an example of another South Asian country; observations range from 2010 to 2012. Langford and Ohlenburg (2016): no data for Nepal and Indonesia; Sri Lanka included as an example of another South Asian country; observations range from 2008 to 2010.

Table 1: Overview of tax buoyancy and tax productivity

Country	Total tax buoyancy	Direct tax buoyancy	Indirect tax buoyancy	Direct tax productivity (2011)	Indirect tax productivity (2011)
Bangladesh	1.15	1.34	1.28	0.07	0.20
China	1.7*	..	..	0.15	0.58
India	0.76	1.01	0.63	0.25	0.67
Indonesia	0.91	0.82	1.01	0.19	0.45
Nepal	..	..	..	0.12	0.35
Pakistan	0.89	1.14	0.97	..	..
LIC average	..	..	..	0.19	0.40

Source: Tax buoyancy: Mansur (2015); tax productivity: IMF (2011a), based on World Economic Outlook data (2010).

* Authors' calculations based on China case study.

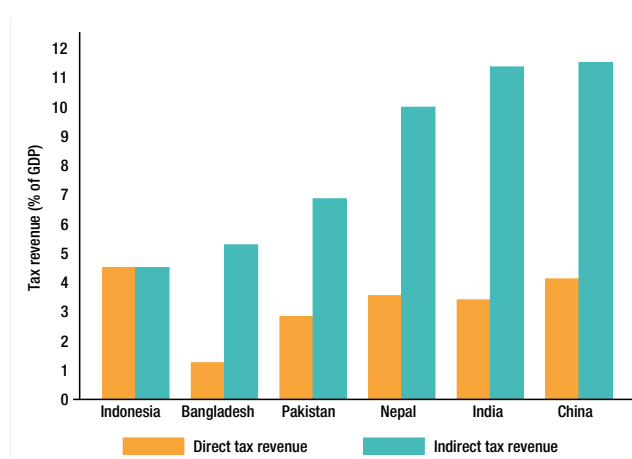
Note: Tax productivity is calculated as the ratio of revenue collections to GDP (or consumption, in the case of VAT), as a percentage, over the respective tax rate. Standard corporate rates are used for direct tax.

Other performance indicators such as tax buoyancy also illustrate the differences in tax systems across case study countries. Tax buoyancy measures the ability of a tax to increase at an equal or faster rate than its base (usually GDP). According to Cevik (2016), tax buoyancy ratios below 1 are indicative of the need for further reforms in order for increases in the tax-to-GDP ratio to be realised. Thus, Bangladesh and China, which have tax buoyancy scores greater than unity, have increased tax collection at a faster pace than their GDP growth rate; in contrast to the stagnation observed in India, Indonesia and Pakistan, which are characterised by below unity tax buoyancy indicators. Indirect tax buoyancy is particularly low in India, while direct tax buoyancy is more of a problem for Indonesia.

2.2. Indirect taxes dominate the tax mix

Reliance on indirect taxation is frequently cited as the reason for the difference in tax levels between richer and poorer countries (Kaldor, 1963; Genschel and Seelkopf, 2016) and South Asian countries are no exception. Indirect tax revenue represents, on average, nearly two-thirds of total tax revenues in the case study countries (see figure 10). This contrasts with a world average of 1.5:1 in favour of direct taxes and 2:1 in OECD countries (Martinez-Vazquez, 2011).

Figure 10: Case countries are reliant on indirect taxes (mean, five years to 2013)



Source: ICTD Revenue Database.

Over the past two decades, gradual VAT reforms across all countries have underpinned increases in indirect tax revenues. However, our case studies note low VAT rates (Indonesia: 10%; Nepal: 13%), high thresholds (Nepal)

and high compliance costs (China, India and Indonesia) as common factors slowing down the rates of increase in VAT collection. As can be seen in Figure 11, although indirect taxes are increasing as a percentage of GDP, in Bangladesh, Indonesia and Pakistan they underperform relative to peer levels.

The share of direct tax revenues has increased steadily across case countries, but remains low in comparison to the average for income level peers. Corporate income taxes largely drove this increase, following the modernisation of tax administrations and the introduction of Large Taxpayer Units (LTUs). Automation, self-assessment schemes and withholding mechanisms have improved Personal Income Tax revenue in Pakistan and Nepal. The limited number of registered taxpayers in Nepal (1.5 million from a population of 28.5 million),⁶ Bangladesh (3.5 million from 160 million),⁷ India (31 million from 1.25 billion)⁸ and Pakistan (1.2 million from around 200 million)⁹ undermines increases in personal income taxes. Overall, the considerable increase in income per capita in the region over the past 25 years – ranging from a doubling in Indonesia to a threefold increase in India and a fivefold increase in Pakistan – indicates direct tax revenue growth has been below potential, as shown in Figure 12.

2.3. Structural characteristics and tax policy constrain tax collection

The earlier observations provide a strong indication that the tax systems of the case study countries have numerous inefficiencies, arising from both tax policy choices and the structural characteristics of their economies.

Common tax policy-related causes for the low revenue productivity across the case study countries include narrow tax bases and a high incidence of tax incentives, exemptions and holidays. Tax expenditure estimates range from 1.3% of GDP in Pakistan (Ahmed et al., 2014) to 5% of GDP in Nepal (Government of Nepal, 2013). These may reduce opportunities for much-needed public spending on infrastructure, public services or social support, or require higher taxes on other activities (World Bank, 2015).

IMF (2011a) argues that the specific characteristics of developing country economies, including the size of their agriculture sectors, low GDP per capita levels, small tax bases and large hard-to-tax sectors (small businesses, including small farmers, professionals, and, in some cases, state-owned enterprises) present significant challenges for sustainably increasing tax revenues (see section 4.2.4 for the political economy implications of a large informal sector). This is particularly the case in South Asia, where the large size and substantial informality of the agricultural sector is compounded by weak administrative capacity and low tax compliance.

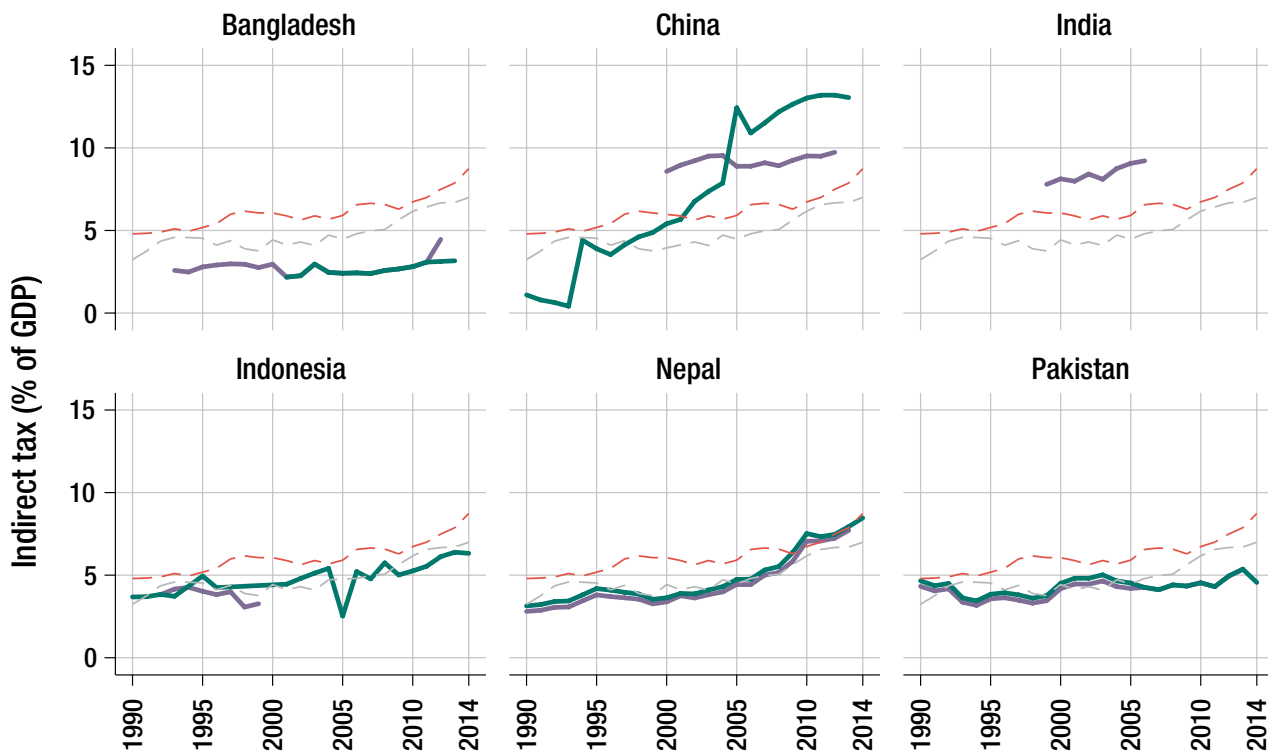
6 Nepal IRD (2016).

7 Bangladesh NBR (2012).

8 ADB (2014).

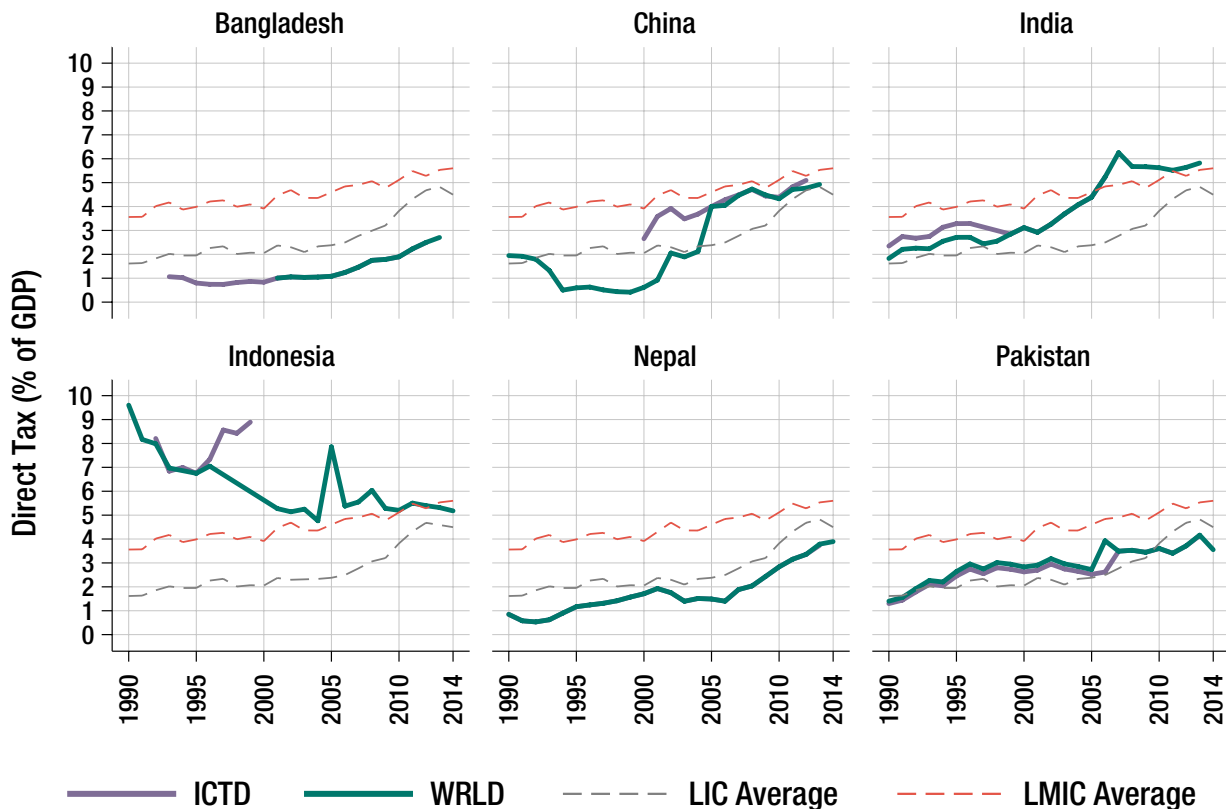
9 FBR Active Taxpayer List.

Figure 11: Case countries underperform relative to their peers on indirect taxes



Source: IMF WRLD and ICTD Revenue Database. ICTD values are used where there are either discrepancies with or missing values in the WRLD. Averages for income groups are calculated using the WRLD. Indirect taxes are proxied by goods and services taxes.

Figure 12: Case countries underperform relative to their peers on direct taxes



Source: IMF WRLD and ICTD Revenue Database. ICTD values appear above where there are either discrepancies with or missing values in the WRLD. Averages for income groups are calculated using the WRLD. Direct taxes are proxied by income taxes.

2.4. Weak tax administrations are a further constraint to tax collection

The capacity of tax administrations is considered to be weak across all case study countries, despite the significant organisational reforms and capacity-building efforts throughout the study period. Von Haldenwang and Yvanina (2011) posit that tax administration performance worsened in recent years across Asia. With the exception of China, all the case study countries rank tax administration reforms among their key priorities for strengthening their tax systems. China's tax administration is well-established at national and various subnational levels, and has made significant improvements according to the World Bank's ease of paying taxes rankings (see Table 2).

Legislative, organisational and managerial factors explain the persistently weak capacity of tax administrations across the case studies. These include: lack of parliamentary oversight for approving tax expenditures in Pakistan; limited coordination and collaboration between tax departments in Bangladesh, India and Pakistan; and poorly trained personnel combined with low salaries in Bangladesh, Nepal and Pakistan. Across case study countries, LTUs have provided a practical, workable solution to effectively use scarce tax administration resources to target large taxpayers.

In addition, the case studies highlight the perception of corrupt tax administrations as an important bottleneck to improving tax compliance and tax morale,¹⁰ particularly in Pakistan and Bangladesh. Examining the average percentage of firms expected to give gifts to tax officials highlights different trends: whereas in India it decreased significantly from 52.3% in 2006 to 15.3% in 2014, in Indonesia it increased from 14.0% to 21.6% over the same period (World Bank, 2016a).

Lack of autonomy exposes the tax administrations in Nepal and Bangladesh to political meddling, undermining the efficiency of their tax administrations. This is despite the fact that the National Board of Revenue (NBR) in Bangladesh was established as a semi-autonomous agency, similar to the Federal Board of Revenue (FBR) in Pakistan. China's State Administration of Taxes is the only fully autonomous agency among the case studies, the other three tax administrations being part of their respective ministries of finance. The Government of India has plans to move towards a semi-autonomous revenue authority (SARA), an administrative reform that has been associated with increased revenue mobilisation in sub-Saharan Africa – although Dom (2017) finds no effects from SARAs on

countries' tax effort, revenue volatility or corruption in sub-Saharan Africa.

Despite these persistent weaknesses in tax administration capacity, notable progress has been achieved. China has built well-established administrative structures at national and various subnational levels, which can support the implementation of further revenue reforms. Nepal's Internal Revenue Department has become a role model, introducing web-based applications and a comprehensive ICT architecture connecting all Inland Revenue Offices (International Tax Compact, 2015): e-filing is now being used for more than 90% of VAT returns, simplifying compliance processes, providing information and reducing costs (Government of Nepal, 2013).

2.5. Poor tax performance indicators conceal reasons to be optimistic following decades of reforms

Significant efforts to undertake tax reforms across the case study countries in recent decades (see section 3) have gradually transformed and modernised their tax systems. While the revenue impact of these reforms has been limited and delayed by political economy dynamics (see section 4), there are reasons to be cautiously optimistic about the countries' capacities to realise their untapped potential in the near future.

The important gap between actual tax-to-GDP ratios and potential tax collection indicate there is a sizeable margin for improving tax-to-GDP ratios. Indonesia, for example, has the potential to significantly increase its non-oil tax revenues. High direct tax buoyancy ratios in Bangladesh, India and Pakistan, and high indirect tax buoyancy ratios in Bangladesh and Indonesia suggest there is potential for raising further tax revenues from these sources in future.

The case studies also note a growing domestic political awareness around the need to pursue further tax reforms in Bangladesh, Nepal and Pakistan. In line with international commitments to increase support to tax systems, this presents opportunities to harness tax reform momentum.

- Pakistan's prolonged economic slowdown since 2008/2009 triggered some bold tax reforms, indicating a willingness to pursue significant tax reforms (Pasha, 2013).

Table 2: World Bank's 'ease of paying' taxes ranking (2016)

	Indonesia	China	Nepal	Bangladesh	Pakistan	India
Ranking: ease of paying taxes (out of 189)	104	131	142	151	156	172

Source: World Bank (2016a).

¹⁰ Tax morale is defined here as per the OECD (2015) definition: 'citizens' perceptions of tax matters'.

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- In recent years, Bangladesh has witnessed a growing assertiveness of more reformist elements of the political leadership, indicating its political economy gridlock may loosen and allow for a modest renegotiation of existing rules governing the tax system (Hassan and Prichard, 2016).
 - Despite concerns about the accuracy of the GDP base, Nepal's continuous tax reforms since the signing of the peace agreement in 2006 have yielded impressive increases in real and real per capita terms,¹¹ in line with its tax administration's ambitious outlook.

¹¹ Revenue grew by 25% and 7% in real and real per capita terms, respectively, over the 15-year period to 2015 (IMF World Economic Outlook data).

3. History of tax reforms in case countries

Key findings

- The 1990s were characterised by a wave of market liberalisation reforms that spread across the region and underpinned tax reforms – in line with the global tax reform agenda of ‘low nominal tax rates, applied to broader tax bases’ (Bird, 2013) pursued by the International Monetary Fund (IMF) and World Bank.
- Major tax reforms were characterised by tax administration modernisation during the 2000s. The introduction of LTUs, as well as the deployment of information technology, appears to have played an instrumental role in increasing direct taxes, particularly corporate income taxes.
- There are some similarities in what motivated and triggered tax reforms across the case studies. The triggers were predominantly economic shocks or crises which resulted in fiscal pressures. As such, increasing tax revenue was the overarching motivation for tax reforms.
- Historically, a relatively small number of donors have played a major role in driving and shaping the tax reform agenda across the region.

3.1. Macroeconomic imbalances are an important trigger for undertaking major tax reforms

Many of the comprehensive tax reforms over the past three decades, identified in the case studies, seem to have been triggered by economic shocks in the form of macroeconomic imbalances or strong revenue pressures (see Table 3). Several countries in the Asia region experienced a balance of payment crisis: India in 1991 (followed by fiscal deterioration in 2003), Nepal in 1992 and Bangladesh in 2011. Indonesia experienced economic shocks associated with declining oil prices in the mid-1980s and the Asian financial crisis in the late 1990s. Pakistan signed an IMF Stand-By Agreement in 2008 to address economic instability caused by internal and external economic shocks in 2007. In contrast, Nepal undertook continuous piecemeal tax reforms in response to minor fiscal deficits and a continuously declining public debt level since the early 2000s. A deteriorating fiscal

situation was the common symptom of these economic shocks and tax reform (to redress the macroeconomic imbalances) was the common response – along with resorting to IMF support (see section 4.3.1).

While comprehensive tax reforms were often designed and decided upon as a response to strong revenue pressures emanating from shocks, their implementation has tended to be piecemeal, with varying levels of success. Previous case study reviews (see World Bank, 1997) argue that the political process in most countries is better equipped to deliver marginal rather than wholesale tax reform. ITC and OECD (2015) note that tax reforms are long-term processes characterised by steps forwards and backwards. The experience of tax reform implementation in the case study countries is broadly consistent with this finding. It took India nearly a decade to fully implement the recommendations of the Tax Reforms Committee Report, agreed and launched in 1991. China approved a five-year VAT reform plan in 2008, but the plan was not fully implemented until 2016. Pakistan’s World Bank-supported Tax Administration Reform Programme (TARP), which lasted from 2005 to 2011, was considered ‘unsatisfactory’ in its performance. Other tax reform programmes were not fully realised, such as Bangladesh’s Customs Administration Modernisation project, initiated in 1999 and eventually scaled back due to numerous delays (Hassan and Prichard, 2016).

3.2. Tax policy reforms lowered nominal tax rates and broadened tax bases

During the 1990s, most of the case study countries moved away from a centrally planned economy towards an open market economy. The thrust of the tax policy agenda of that period can broadly be defined as ‘broadening bases, lowering nominal rates’, designed to support broader market liberalisation reforms. This was very much in line with the global tax reform agenda that emerged as part of the Washington Consensus (Bird, 2013; Fjeldstad and Moore, 2008; Stewart, 2003). The main components of this agenda were: substantial reductions in import tariffs, the introduction of broad-based consumption taxes such as VAT, simplified tax design, broader bases and lower rates,

Table 3: Chronological overview of the main comprehensive tax reforms for each country and their related political economy triggers

Year	Main tax reform	Associated political economy trigger
Bangladesh		
1991	Implementation of VAT under IMF pressure	Critically low government revenue (7% of GDP)
2004	Introduction of LTUs for income tax, and Central Intelligence Cell	
2011-2016	Comprehensive revenue authorities' modernisation plan to support reform of the VAT and Income Tax Act	Growing fiscal pressure Mounting external pressure for new VAT law
2012	Enactment of new VAT and Supplementary Duty Act 2012 (component of the Tax Modernisation Plan)	Balance of payment crisis (2011) and persistent fiscal deterioration, requiring an IMF extended credit facility
China		
1994	Tax policy and administration reforms, focused on simplifying taxation	Strong decline of general government revenue due to continued market liberalisation reforms
1999	Implementation of China's Tax Administration Information System	Slowdown in the Chinese economy partly due to the Asian financial crisis
2008	National People's Congress approves the national five-year plan for VAT reform	Global economic crisis
2016	VAT reform: inclusion of the Business Tax and key services into VAT	Services industry makes up more than half of the Chinese economy
India		
1991-1999	Implementation of the tax policy and administration reforms recommended by the Tax Reforms Committee	Balance of payment crisis, triggering IMF support and structural adjustment programme
2002	Tax policy reforms and modernisation of tax administration	Worsening fiscal deficit and high public debt
2015	Comprehensive approach to modernise tax administration	Increasing pressure on India's economy and business environment to remain attractive and competitive for foreign investors
2017	Approval of GST Bill*	Landmark indirect tax reform expected to put Indian economy on high growth trajectory
Indonesia		
1983-1987	Comprehensive overhaul of both tax policy and administration, including the introduction of VAT	Oil price shock and economic downturn
1998-1999	Tax policy and administration reforms	Asian financial crisis and IMF support
2003-2009	Government Financial Management and Revenue Administration Project	Exit from IMF's Extended Financing Facility and commitment to post-programme monitoring
2009-2010	Fiscal stimulus package. Corporation Income Tax and Personal Income Tax reforms, tax waivers and import duty waivers	Global economic crisis
Nepal		
1992	Wave of comprehensive tax policy and administration reforms	Balance of payment crisis requiring an IMF Enhanced Structural Adjustment Facility and pressure to keep pace with India's market liberalisation reforms
1997	Introduction of VAT	Political instability following the onset of the Maoist rebellion in 1996
2002	Income Tax Act, including creating the Internal Revenue Department by merging the VAT department and the income tax department	Continued political instability, combined with marked slowdown during the 2000s – averaging only about 3% growth annually
2014	Formation of the High-Level Tax System Review Commission to recommend taxing rights across different levels of government	Ongoing negotiations over Nepal's new constitution and the related allocation of taxing rights to central, provincial and local governments

Table 3: Chronological overview of the main comprehensive tax reforms for each country and their related political-economic triggers (continued)

Pakistan		
1988	Elected government requested IMF Structural Adjustment Facility, including comprehensive tax policy and administration reforms	Transition from military dictatorship to democracy
1999	IMF Poverty Reduction and Growth Facility signed	Military coup followed by military government (until 2008)
2005-2011	Comprehensive tax administration modernisation plan (World Bank/DFID-supported)	
2013	IMF programme signed with tax policy structural benchmark	First democratic transition of government
2015- 2018	Comprehensive project on Tax Policy and Tax Administration (World Bank/DFID-supported)	

* *Goods and Services Tax. Previously, the authority to collect taxes was split (bifurcation) between the central and state governments (similar to Pakistan) with states collecting taxes on goods and the centre collecting taxes on services, which caused a lot of the tension and difficulties for VAT collection.*

Source: Authors' elaboration, based on case studies.

Note: This table compiles the main tax reform initiatives since 1990. It does not provide an exhaustive overview of all major and minor tax reforms undertaken in the case study countries. For more detailed reviews, please refer to the specific case studies.

few or no tax incentives, and improved tax administration (IMF, 2011a).

A common tax reform priority for all six countries during the 1990s was to increase their other indirect taxes to compensate for declining trade tax revenues from import tariff reductions. In contrast to sub-Saharan Africa, where VAT was typically introduced quicker and with fewer exemptions, the introduction of VAT in Asia was a slow and gradual process, exempting many sectors and applying differential rates (Hassan and Prichard, 2016). In India and Pakistan, the transition from trade revenues to VAT initially led to a reduction in total tax revenues due to the slow implementation of VAT reforms, which remained plagued by exemptions. These challenges broadly mirror the experiences of developing countries more generally, which have struggled to mobilise the domestic tax revenues required to compensate for the loss of revenue caused by trade liberalisation and tariff rationalisation (Baunsgaard and Keen, 2010; Keen, 2009). These tax reform 'waves' throughout the 1990s have been highly transformative, making tax policies in these countries more aligned with international best practice.

This shifting focus in tax systems, from trade to domestic taxes, was further fine-tuned throughout the 2000s, with a continued focus on indirect tax revenues. Bangladesh reformed its VAT in 2012 by introducing a single VAT rate (15%) and limiting exemptions in its 1991 VAT law. Nepal increased its single VAT rate from 10% to 13% in 2005. Both China and India undertook major VAT reforms, in 2008 and 2017 respectively.

Other tax policy reforms of that period focused mainly on broadening tax bases by reducing exemptions and increasing voluntary compliance (by simplifying tax systems to lower compliance costs). Following Pakistan's first democratic transition in 2013, the government signed

up to a new IMF programme that included structural benchmarks to reduce Statutory Regulatory Order (SRO) exemptions and limit the Federal Board of Revenue's authority to further SROs. In 2015, reform priorities from Nepal's High-Level Tax System Review Commission included broadening the VAT base, simplifying its major taxes through a unified tax code and publishing tax expenditures as supplementary information in the annual budget. In 2008, Indonesia simplified its tax return filing system.

3.3. Tax administrations have been gradually modernised

Most countries in the region embarked on significant tax administration modernisation reforms, which picked up speed from the early-2000s. Tax administration reforms tended to be embedded in comprehensive TARPs that span multiple years. These included significant organisational changes, like the establishment of Nepal's Internal Revenue Department in 2002 or Bangladesh's restructuring of its revenue authority according to function and size. They also included multiple reforms at the margins, aimed at improving enforcement and compliance in all case study countries:

- Pakistan's 2005-2011 TARP included management and institutional development, the adoption of responsive IT systems, upgrading infrastructure and strengthening enforcement. The project aimed to make tax collection more efficient and effective; promote compliance with tax laws and broaden the tax base; and promote trade facilitation. However, the World Bank's completion report considered both the results and the performance

of the government over the lifecycle of the project as ‘unsatisfactory’.

- Indonesia’s 2003-2008 Government Financial Management and Revenue Administration Project focused on establishing a medium and a small taxpayer unit, improving audits, performance measurement, human resources policies and ICT systems. Modernising Indonesia’s tax administration was a priority area for a post-IMF economic policy package, designed to ensure macroeconomic stability.
- Bangladesh’s 2011-2016 Tax Modernisation Plan focused on several strategic areas, to put in place an efficient, taxpayer-friendly and fair tax regime. The Plan recognised the critical need to increase tax revenue to achieve the government’s medium-term revenue target of a tax-to-GDP ratio of 12.2% by FY2016.
- The introduction of LTUs, alongside the deployment of information technology, appears to have played an instrumental role in increasing direct taxes, particularly corporate income taxes.
- Bangladesh’s 2011-2016 Revenue Authority Modernisation Plan aims to build a digital NBR to address human resources constraints and eliminate its paper-based assessment system. To date, the NBR has made progress in improving revenue administration by automating tax reporting and collection – for example, introducing taxpayer identification numbers and expanding online tax filing.
- Nepal’s tax administration successfully adopted a system of e-governance for online registration, filing and payment, and gradually introduced a comprehensive ICT architecture connecting all Inland Revenue Offices. The Customs Department also underwent a number of reforms including a post-clearance audit, becoming a member of the World Trade Organization, computerised registrations and declarations, deployment of Automated System for Customs Data software, and the removal of duties on exports. More recently, the Internal Revenue Department established a call centre, a risk-based audit, online tax clearance certifications and a large taxpayer office.
- In India, the introduction of the Tax Information Network was particularly important for developing an efficient information system to improve tax compliance. India’s tax reform experience signals the importance of designing and sequencing tax policy reform in accordance with national tax administration capacity.

Tax administrations appear to have gradually shifted away from an exclusive ‘enforcement’ approach, towards a more taxpayer-friendly ‘service delivery’ approach. TARPs increasingly include measures to motivate voluntary tax compliance – such as taxpayer education in Nepal, strategic communication in Bangladesh or transparency initiatives in Pakistan. To counter India’s perception as an unfriendly investor destination, India’s Tax Administrative Reform Committee (Government of India, 2015)

recommended a ‘comprehensive’ transformation of tax administration, founded on accountability and recognition of the taxpayer as a ‘customer’. This cultural shift within tax administrations is in line with findings from the OECD (2015), which takes stock of taxpayer education strategies across 28 developed and developing countries.

3.4. Tax reforms were largely donor-designed

Multilateral assistance played an important role in designing and financing the comprehensive tax system reforms in Bangladesh, Indonesia, Nepal and Pakistan. The IMF and the World Bank Group (WBG) provided the largest multilateral support. The former typically focused on strategic policy advice, and on supporting policy and administration reforms, while the latter funded tax administration reforms as part of broader public finance management reform projects:

- In Bangladesh, multilateral institutions have been key in supporting agents for reform in the country, and have provided technical guidance and conditionality to support the reform process. In 2011, Bangladesh’s comprehensive Tax Modernisation Plan was prepared with donor assistance, in particular from the International Finance Corporation (IFC).
- In Indonesia, successful reforms often involved donor support, but donor pressure on its own has often not been enough to create reform space without also harnessing domestic pressure.
- Nepal’s first wave of tax reforms in the 1990s, including the introduction of VAT in 1997, was part of the Enhanced Structural Adjustment Facility agreement signed with the IMF.
- Most of Pakistan’s tax policy reforms since the early 1990s have been carried out at the behest of the IMF, which requires fiscal discipline and revenue mobilisation as part of its arrangements – including the move towards aligning sales tax on goods to a VAT-based tax and introducing a Reformed General Sales Tax bill. One reason behind this donor-prompted tax reform was to give ‘political cover’ to the government to undertake these difficult reforms.

Bilateral donor assistance to tax systems in Bangladesh, Nepal and Pakistan played a more supportive role at the margins of the larger multilateral, multi-year tax reform programmes (see Table 4). DFID, GIZ, USAID and, to a lesser extent, the Danish Development Cooperation (DANIDA) were the most prominent bilateral donors, providing capacity-building to tax systems in these countries. Bilateral support was provided mostly through technical assistance and focused largely on measures to broaden the tax base – such as taxpayer registration in Nepal, improving tax compliance in Bangladesh and modernising tax administrations in all three LICs.

Table 4: Overview of international support to tax reforms in Bangladesh, Nepal and Pakistan (1990-2017)

Recipient	Partner	Activity	Date
Nepal	GIZ	Internal Revenue Department (TA) 2008-17	
	IFC	'Global Tax Simplification Programme' (TA)	2010
	IMF's Fiscal Affairs Department (FAD)	'Customs Reform and Modernisation Action Plans' (TA)	2003-17
	IMF–USAID–GIZ/DANIDA	VAT implementation, self-assessment system and creation of the Internal Revenue Department (TA)	1992-2003
	World Bank-administered Multi-Donor Trust Fund (MDTF) (Australia, Denmark, European Union, Norway, Switzerland and United Kingdom)	Mandate of the MDTF: strengthen the performance, transparency and accountability of public financial management	Est. 2010
Bangladesh	Asian Development Bank	Investment project to support the modernisation of the Income Tax Wing	Not specified
	DFID	'Tax Administration Capacity and Taxpayer Services' project (TA to NBR)	2011- onwards
	DFID	'Reforms in Revenue Administration' project (support the creation of the LTU and Central Intelligence Cell in the NBR)	2002-07
	IFC	'Tax Modernisation Plan' through investment in the Climate Trust Fund (TA)	Not specified
	IMF FAD	VAT implementation; resident adviser and short-term advisers in the VAT Wing (TA)	1990- onwards
	WBG International Development Association (IDA)	Funding for the 'Revenue Mobilisation Programme for Results' and the 'VAT Improvement Programme'	2014-19
	World Bank	'Revenue Administration Modernisation Programme'	1999-2008
Pakistan	GIZ	CB and TA for the FBR to support the establishment of the data warehouse	Ongoing
	IMF	IMF Structural Adjustment Facility, including for policy and administrative reforms	1998/99-2000/01
	IMF	IMF Stand-By Arrangement	2008- onwards
	World Bank/DFID	Tax component of the 'Trust Fund for Accelerating Growth and Revenue'	2015- onwards
	World Bank/DFID	Funding to the TARP	2005-11

Source: Authors' elaboration based on case studies. Note: TA = technical assistance; CB = capacity-building. There was insufficient documentation on external support to tax reform in India, Indonesia and China for similar inclusion above.

4. Political economy of tax reforms in case countries

Key findings

- Strong opposition from special interest groups (political parties, economic elites and revenue authorities) means that to be successful, tax reforms have to focus more on what is politically feasible than on what is economically desirable. Turning points are difficult to predict, which highlights the benefit of long-term engagement as a means of supporting reformers when windows of opportunity present themselves.
- These groups of domestic stakeholders, who are threatened by tax reforms, tend to be more informed, organised and politically connected through informal networks and norms. This enables them to influence tax negotiations in their favour at the expense of the wider public, who would otherwise benefit from increased tax revenues for public spending.
- Involving non-governmental actors (including businesses, civil society and the media) is essential for balancing tax reform negotiations in favour of the public interest: towards more productive, equitable and fairer tax systems. The case studies suggest there is still a long way to go towards improving tax morale and strengthening the fiscal legitimacy of the state through better public spending.
- Donors have assumed different roles in tax reform, sometimes acting as a scapegoat for reformist governments (who can use lending conditionalities as a reason for implementing unpopular tax reforms) and, at other times, supporting domestically-led tax reforms. The quality of donor coordination and collaboration can impact the outcome of capacity-building around tax systems.
- Asia, and especially South Asia, is relatively poorly networked in terms of regional tax policy and administration. While there are clear regional groupings in Southeast Asia for taking forward coordination on tax policy (ASEAN) and tax administration and peer learning (SGATAR), coordination in South Asia is complicated by the India–Pakistan relationship.

4.1. A diverse range of stakeholders influence tax reforms

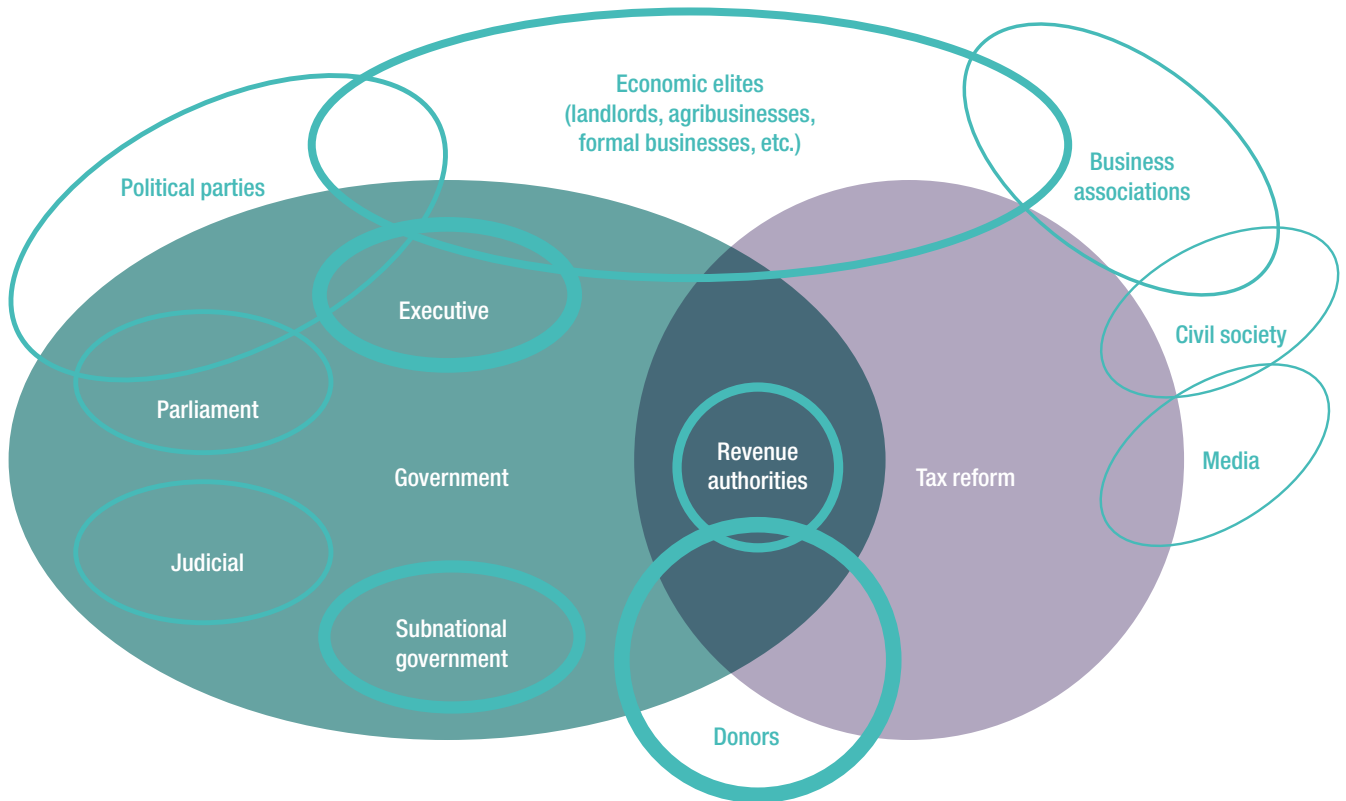
A diverse group of stakeholders have influenced the timing, design and outcome of tax reforms across all six countries (see Figure 13). A variety of government actors directly shape political decision-making, leading to complex negotiation processes between different levels of government. Non-governmental actors, including businesses, broader civil society and the media, also play key roles in influencing tax reform design and implementation when they can block tax reforms (World Bank, 2016b). Our case studies find that different stakeholder groups are interconnected through informal networks and norms, which enable them to slow down and counter tax reforms to preserve their narrow economic or political interests.

Table 5 provides a basic overview of the common stakeholders for tax reforms across the six case study countries, and identifies their main motivations and how they either supported or blocked tax reforms in specific countries. In line with findings from the literature (Olofsgard, 2003), groups that are threatened by a tax reform (potential losers) exert influence either directly, through their ability to block the enactment of reforms in parliament, or indirectly, by persuading politicians to opt for the status quo.

4.2. Political economy dynamics diluted tax reform outcomes

Fundamental tax reforms require policy-makers to balance the different goals that tax systems aim to achieve, while considering the major political economy challenges they are likely to face before, during and after the tax reform process (Brys, 2016). As described in the six country case studies, economic and political pressure for *de jure* reforms frequently come into conflict with political economy pressures to preserve the key formal and informal features of the prevailing status quo. This necessitates a consensual approach to managing tax reforms, characterised by piecemeal implementation and difficult trade-offs. The experiences from China, India and Indonesia illustrate how

Figure 13: Common stakeholders shaping tax reform outcomes



Source: Authors' elaboration based on case studies and G20 paper (2016). The weight of a shape's outline proxies the relative influence of each stakeholder group.

their tax reforms were guided more by what was politically feasible than what was economically desirable.

This section highlights and describes apparent commonalities in political economy dynamics that influenced tax reform outcomes among each main stakeholder group. Our case studies have used a semi-structured approach to allow for the identification of potential commonalities in political economy dynamics across the countries. However, political economy analysis is highly country and context specific. Therefore, caution is required when generalising findings. To maintain the level of granularity and detail captured by the case studies, relevant differences across countries regarding each stakeholder group have been highlighted.

4.2.1. Elite patronage networks and bureaucratic rent-seeking influence tax administration reforms

In Bangladesh, Nepal and Pakistan informal rules, norms and networks have resulted in a tax system which is mutually beneficial to powerful political, economic and administrative actors. These actors are potential losers from changes to the status quo and have undermined donor-supported tax reform efforts.

In Bangladesh, the political elite has captured the existing tax system for fundraising and the delivery of patronage to its business allies. Informal networks, which are essentially non-partisan, have enjoyed high-level political support – reaching as high as the Prime Minister's Office – enabling them to influence hiring and promotion decisions within the

NBR, and to remove those who challenge their interests and those of their allies (Hassan and Prichard, 2016).

The government managed to reconcile external pressure for de jure policy reform with a desire to preserve the rent-seeking opportunities of the existing tax system. They agreed, for example, to a gradual implementation of the 1991 VAT reform, allowing the government to negotiate and selectively add special regimes and exemptions, delaying the introduction of full VAT coverage until 2004. With respect to the most recent VAT reform, delaying reforms to the administration (which are critical to its implementation yet less subject to donor conditionalities) may continue to stall progress (Hassan and Prichard, 2016).

Similarly, in Nepal, the dominance of one caste (Brahmins) in the exercise of political and bureaucratic power, in combination with informal institutions (ranging from bureaucratic and legislative norms to clientelism and patronage), have had a profound effect on tax reform outcomes. Frequent turnover at the political level has constrained the implementation of tax reforms, and has often held the public administration hostage to electoral and political interests. Ministerial posts often serve as rewards for coalition partners, resulting in frequent changes at the top and attendant changes in the bureaucracy.

In contrast, in Indonesia, Suharto's autocratic regime and its coalition of large entrepreneurs, nationalists and technocrats – which relied on a patronage system based on (natural resource) rents and state-granted monopolies – used tax reform to create rents to maintain legitimacy and political support when its existing rents were threatened.

Table 5: Overview of the common stakeholders and their actions shaping tax reforms in case study countries

Stakeholders	Motivations	Actions to block tax reforms	Actions to enable tax reforms
1. Political elites: <ul style="list-style-type: none"> • Heads of state • Autocratic regimes • Finance ministers • Political parties • Executive • Parliament • Judiciary 	<ul style="list-style-type: none"> • Raising tax revenues to finance public policies • Attracting foreign direct investment • Consolidating power and narrow political interests • Political survival through re-election and maintaining a positive (reformist) public image • Delivering patronage to political and economic allies • Developing rent-seeking opportunities • Fundraising for campaign financing 	<ul style="list-style-type: none"> • Politicisation of the tax system through high-level appointments of political allies in revenue authorities (Bangladesh, Nepal) • Delaying ratification of tax laws (Bangladesh) • Opposition to proposed tax reforms from governing coalition (India) • Backing off from tax reforms strongly opposed by citizens (Pakistan) • Poor drafting of laws, which complicates their enforcement through courts of law (Pakistan) 	<ul style="list-style-type: none"> • Providing high-level political support and 'reform space' to major tax reforms (Indonesia, India) • Setting out clear tax system reform priorities (Indonesia) • Promoting internal consensus to give direction to tax reforms – crucial condition for success (Indonesia) • Increasing 'receptiveness' to undertake tax reforms (Bangladesh, Pakistan)
2. Bureaucracy: <ul style="list-style-type: none"> • Revenue authorities 	<ul style="list-style-type: none"> • Maintaining discretionary powers for rent-seeking activities • Career/job promotion • Perception/kudos of a modern and functioning tax administration 	<ul style="list-style-type: none"> • Creation of informal rules affecting revenue administration and tax policy implementation (Bangladesh, Pakistan) • Cumbersome administrative requirements facilitating rent-seeking (Pakistan, Nepal) • Delaying major governance-related tax administration reforms (Bangladesh) • Granting SRO exemptions without parliamentary oversight (Pakistan) • Hiring and staffing policies that encourage high staff turnover (Bangladesh, Nepal, Pakistan) • Ideological battles at cabinet level between technocratic reformists and economic nationalists slow down reform (Indonesia) 	<ul style="list-style-type: none"> • Important partner for designing 'technocratic' reform proposals (India, Indonesia) • Set up a 'revenue cadre' to enhance professionalism in tax administration (Nepal)
3. Subnational governments: <ul style="list-style-type: none"> • State governments • Provincial governments • Local governments 	<ul style="list-style-type: none"> • Obtaining larger shares of domestic revenue (through transfer agreements, taxing rights, etc.) to meet increasing expenditure needs • Quest for more autonomy • Reluctance to lose taxing rights 	<ul style="list-style-type: none"> • Negotiating revenue compensation mechanisms to offset potential revenue losses (China, India) • Undermining fiscal reforms by resorting to ad hoc fees for additional, off-budget revenue generation (China) • Opposing property tax reforms (China) • Specific economic interests from subnational governments influence support for tax reforms (India) • Federal–State dynamics, which undermines the collection of sales tax (India, Pakistan) 	<ul style="list-style-type: none"> • Support from subnational governments is essential for passing major tax reforms in federal states (India, China) • Bargaining power depends on political alignment with governing coalition and its economic clout, determined by its population and GDP (India)

Table 5: Overview of the common stakeholders and their actions shaping tax reforms in case study countries (continued)

Stakeholders	Motivations	Actions to block tax reforms	Actions to enable tax reforms
4. Economic elites: <ul style="list-style-type: none"> • Agribusiness • Industry • Service sectors • Landlords • Formal small and medium-sized enterprises (SMEs) • Tycoons • Business associations 	<ul style="list-style-type: none"> • Lower nominal and effective tax rates • Lower compliance costs • Obtain tax exemptions • Avoid audits • Improve business environment • Avoid periodic tax harassments 	<ul style="list-style-type: none"> • Lobbying for exemptions, incentives, special regimes and informal benefits through business associations (Bangladesh, India, Indonesia, Nepal, Pakistan) • Opposition to taxing agricultural sector (India, Nepal) • Collusion with political elite to influence tax reforms (Bangladesh, India, Indonesia, Nepal, Pakistan) • Financing political campaigns (India, Indonesia) • Leveraging promises of job creation and investment to obtain preferential tax treatment (India) • Staging protests to influence tax negotiation outcomes (Pakistan) 	<ul style="list-style-type: none"> • Stakeholder in fiscal bargaining (India, Pakistan) • Implementation partner for tax support projects (Nepal)
5. Civil society: <ul style="list-style-type: none"> • Taxpaying citizens • The media • Civil society organisations 	<ul style="list-style-type: none"> • More equitable and fairer tax systems • Promoting transparency to strengthen state accountability towards citizens • Ensure taxes are well spent by the government 	<ul style="list-style-type: none"> • Staging public protests against tax reforms (Pakistan) • Low tax compliance (Bangladesh, India, Nepal) 	<ul style="list-style-type: none"> • Electoral pressure to block/create reform momentum after elections (Indonesia) • Press and media campaigns to influence tax reforms (Indonesia) • Implementation partner for tax support projects (Nepal)
6. International donor community: <ul style="list-style-type: none"> • IMF • WBG • Asian Development Bank • DFID • USAID • GIZ • DANIDA 	<ul style="list-style-type: none"> • Increasing tax revenues for financing domestic development priorities and exiting aid dependence • Promoting equity, efficiency and fairness in tax systems • Strengthening state accountability and legitimacy • Fiscal consolidation for repaying international loans 	<ul style="list-style-type: none"> • ODA inflows lower tax effort (Pakistan) 	<ul style="list-style-type: none"> • Technical assistance to design and implement tax reforms • Building capacity in tax systems • IMF support agreements, which contain tax reform measures (Bangladesh, India, Indonesia, Nepal, Pakistan) • Scapegoats for national governments to pass through difficult tax reforms (Pakistan) • Assertively driving tax reform in partner countries (Pakistan, Bangladesh)

Ideological battles at cabinet level between technocratic reformists and economic nationalists conditioned the design of tax reforms and delayed their implementation.

4.2.2. Vested interests of economic elites and related corruption undermine tax policy reforms

Economic elites have been particularly successful in limiting the impact of tax reforms on their economic activities. They influence tax policy directly, by obtaining political positions or financing political parties, as exemplified in the cases of Bangladesh and Indonesia. They also exert pressure on policy-making indirectly through business associations and lobbying groups to obtain preferential tax treatment, as found in the cases of India and Pakistan.

Countering these elites' opposition to tax reforms requires building a broad coalition capable of advocating for a change in the status quo. This hinges on making tax reforms more palatable to the public, particularly the majority of the population that would potentially benefit the most from increased public spending on social services and productive investments. This, in turn, requires improving the quality of public spending, perceptions of the tax administration, the equity of the tax system and the framing of tax reforms: creating a narrative of inevitability with respect to the potential benefits they will deliver. The more citizens perceive their government to be accountable, the more willing they will be to pay tax for the services provided. This improved 'tax morale' will limit the need for coercion, thereby reducing collection costs and facilitating tax administration through higher levels of voluntary compliance (AfDB, 2011).

However, the case studies suggest there is still a long way to go towards improving tax morale and strengthening the fiscal legitimacy of the state through better public spending:

- In Bangladesh, government spending lacks transparency and credibility (Sarkar et al., 2015). Riddled with corruption, the administration may not be living up to the expectations of the taxpayers. In addition, 'free-riding' or non-payment of taxes demotivates honest taxpayers and negatively impacts tax morale.
- The widespread perception within Pakistan that government spending is inefficient reduces citizens' willingness to pay tax and weakens tax morale. Its business community has little incentive to support tax reforms in exchange for publicly provided services, as they can generally afford higher quality private substitutes in sectors such as education and health.
- According to the Government of India (2016), the very limited number of citizens paying income taxes undermines the functioning of its democracy. In addition, India's public service delivery is considered of such low quality that its citizens would rather pay for services out of their own pocket than use existing public services paid for with taxes. This risks creating a vicious circle of low tax compliance and poorly funded government service provision, undermining state legitimacy. Therefore, increasing Indian citizens' tax morale requires changing the current perception that taxes serve to sustain a costly and ineffective state (Aiyar and Pritchett, 2015).
- In contrast, China's better quantity and quality of economic and social services (compared to most developing countries in Asia) suggests that a strategy of maximising revenue supports effective service provision, despite the absence of free-functioning markets and political opposition.
- In Indonesia, low tax levels combined with natural resource wealth means that citizens may lack the necessary leverage to push for increased accountability around public expenditure.

The case studies find that corruption and related tax evasion also significantly limit revenue collection from economic elites. Common characteristics which facilitate evasion include: a low likelihood of being caught, a public perception of corruption within revenue authorities, and the prevalence of a cash economy, which complicates auditing and tax enforcement.

- In Bangladesh, senior management within the NBR exercise centralised oversight over day-to-day operations, corruption and negotiation (Hassan and Prichard, 2016).
- China's over-reliance on land leasing fees has been criticised as an important driver of the increase in house prices, and the growth of corruption cases and land disputes across the country. Moreover, the perverse incentives associated with the land use fee have made local authorities the biggest opponent of any property tax reforms.
- Despite recent improvements, Indonesia's weak and corrupt administration is still considered the primary reason for constrained revenue mobilisation. Persisting ambiguities and inconsistencies in tax laws have created ample space for discretion, resulting in mistrust between taxpayers and the Directorate General of Taxes, affecting compliance.
- In Nepal, the risk of an individual being caught and punished for corruption is low, not because oversight agencies and civil society groups do not exist, but because the networks of powerful actors are able to block any individual challenges to their power. Any future efforts to fight corruption need to take these factors into account (Dix, 2011).
- The public perception of rampant corruption in revenue agencies is cited as the main factor contributing to Pakistan's low tax morale.

Furthermore, our case studies find a trend of increasing personification of politics in Asia, making political campaigns more expensive. In turn, this incentivises collusion between political and economic elites. Through funding electoral campaigns, economic elites aim to gain significant leverage and influence over tax policy-making.

- India's current system for financing political parties, mainly through donations from undisclosed sources, perpetuates the idea that these donations result in crony capitalism.
- Bangladeshi businesses offer political support and financing that cuts across partisan lines, to ensure that they continue to benefit from lower tax rates through

corruption and collusion, perpetuating the status quo (Hassan and Prichard, 2016).

- The introduction of direct presidential elections in Indonesia in 2004, in combination with a dysfunctional party system and the rise of the media, have led to a personification of politics and have dramatically increased the cost of campaigning. This has brought politicians closer to economic elites, providing the latter with ample opportunity to paralyse the policy-making process.
- In Nepal, the nomination of important business people as members of the Constituent Assembly by all of the three major political parties reflects the close links between political and private sector leaders.

4.2.3. Relations with subnational governments complicate tax reforms

The allocation of different taxing rights to different levels of government in China, India and Pakistan determines the tax capacity of each government level, making them powerful stakeholders in tax reforms. India and Pakistan are characterised by a federal-state structure. Their respective constitutions assign taxing rights for specific sources of income to either the centre or the subnational level. Difficulties in reforming the tax system arise when the rights to levy one type of tax (e.g. direct tax) are split across different levels of government. In both countries, for example, income tax is levied by the central government, except for income from agriculture, which is levied by the states or provinces. Changing these taxing rights to simplify and improve the tax system requires a constitutional amendment, which is politically difficult to achieve.

Such contexts lead to complex bargaining processes between the different levels of government, and between executives and legislatures, to overcome the constitutional hurdles to modernising tax systems.

- In India, mechanisms to compensate short-term revenue losses by state governments were important elements of the fiscal bargain and helped to obtain state support for the 2017 GST reform – which replaces the various central and state taxes with a unified national GST.
- In Pakistan, the revenue-sharing arrangement, which assigns 57.5% of federally collected revenue to provinces, creates major motivational problems for revenue generation at both the federal and provincial levels. This includes the splitting of GST revenue assignments between the local (services) and national (goods) levels, which results in the fragmentation of the tax system and the attendant inefficiencies arising from lack of coordination.
- China's 1994 tax reforms granted different taxing rights to central and subnational governments, with the latter allocated the less buoyant taxes. In combination with increasing expenditure responsibilities at subnational level, the reform created pressure to provide subnational governments with a larger share of the centrally collected tax revenue through fiscal transfers as part of the overall tax bargain.

Box 1: Implications from Nepal's incipient fiscal federalism structure

Nepal was transformed from a unitary system of government to a federal system after the promulgation of the current constitution on 20 September 2015. This new constitution assigns taxing rights across the central, provincial and local government levels. While the tax base for each type of tax is allocated uniquely to one specific level of government, the tax base for income tax is split across the central and provincial governments. The central government can collect personal and corporate income taxes – except taxes from agricultural income, which are allocated to the provincial governments. Nepal thus risks replicating the direct tax structure in India and Pakistan, which has significantly slowed down reforming and modernising direct taxes in these two countries.

The constitutional assignment of income taxes across different levels of government may make any future comprehensive reforms to income taxes in Nepal very difficult. It makes both central and provincial governments important stakeholders in comprehensive tax reform. Future attempts to simplify and streamline income taxes would therefore require a complex consensual agreement that assured potential revenue losses incurred by any of the government levels would be compensated for. In addition, future shifts in taxing rights across government levels will require amending the constitution. Nepal's protracted and complex negotiations to agree on its recently approved constitution indicate this may be highly contentious.

The stakes are high as 'a hasty implementation of a new framework for federal fiscal relations as mandated under the constitution could strain the government and its finances given prevailing weaknesses in public financial management (PFM) and institutional capacity' (IMF, 2017a).

These examples highlight the fact that the timing and sequencing of successful tax reforms, which are notionally driven by economic efficiency, must be grounded in political realities (See Box 1).

4.2.4. Political economy of taxing the poor and the informal sector

Large informal sectors pose a common challenge to increasing direct taxes in poor countries (Besley and Persson, 2014). This issue is particularly prescient for Bangladesh, India, Nepal and Pakistan, which all have large informal sectors and high levels of poverty. As argued in the Pakistan case study, political leaders are unlikely to have a strong incentive to tax informal businesses and earners as they risk alienating a majority of their constituents for very little return in terms of increased revenue. At the same time, the administrative costs may also outweigh

the benefits. ICTD (2014) argues that it may not be in the interests of politicians to regulate the informal economy, as it constitutes a captive source of votes.

As a result, all six case study countries are reliant on indirect taxation, which tends to be regressive because it falls on the consumption of goods and services, which make up a larger share of the budgets of poorer households. Lower rates and exemptions may partly address this, but at the cost of foregone revenue. Anand et al. (2014) find that India has the potential to use some of the additional revenue from increased consumption taxes to offset their regressive impact by increasing spending on the country's key social transfer programmes. In the absence of more direct tax collection, indirect taxes may be the most viable current source of finance for progressive spending.

Claus et al. (2013) assess the impact of government fiscal policies on income inequality across Asian countries. Their findings suggest that redistributive policies implemented with spending programmes on social welfare and the social sectors can be more effective than progressive tax reforms. Taxation, however, is crucial for raising finance for government expenditure to achieve distributional objectives. Furthermore, experiences from the middle-income case study countries indicate that implementing effective pro-poor fiscal policies is not straightforward:

- Lustig (2015) concludes that, of the seven middle-income countries in her study, Indonesia's fiscal policy has the smallest redistributive effect. She reports that Indonesia's net indirect taxes are regressive and that total spending on education and health does not sufficiently benefit the poor.
- Cevik and Correa-Caro (2015) find that China's tax incidence remains regressive, with taxes accounting for 10.8% of annual income among the bottom decile of households (and 13.3% among the bottom five percent), compared with 8.7% for the top decile. This is largely because China collects more than half of its revenues from indirect taxes (ibid.). The OECD (2017) concurs that China's tax-and-transfer system does not narrow the gap between the richest and poorest households.¹² They argue this is partly because many households in the lowest income quintile pay a much higher share of their income in social security contributions than those with higher incomes.

Empirical estimates by Claus et al. (2013) suggest personal income taxes are more progressive in Asia than in the rest of the world, possibly because of a larger number of people not paying income tax due to higher tax-free thresholds. Tax concessions reduce the redistributive impact of personal income taxes if they are mainly captured by higher-income earners. Corporate income taxes, on the other hand, may be less progressive (ibid.). They argue this could be due to larger tax incentives, exemptions and concessions for Asian firms. If lobbying power is concentrated among high-income groups, tax incentives and

concessions would be expected to reduce the redistributive impact of corporate income taxation. A distributional analysis of the tax systems of the case countries was outside the scope of this paper due to lack of comparable data.¹³

4.3. Funding conditionalities and political shifts encouraged tax reform

4.3.1. Tax reforms are frequently motivated by the conditionalities of donor support

Fiscal deterioration resulting from macroeconomic shocks created windows of opportunity for donors to encourage comprehensive tax reforms (see Figure 14). These macroeconomic crises enabled the IMF and the WBG to 'push' for comprehensive tax reforms: funding conditionalities were included in their macroeconomic support agreements, as discussed in the case studies for Bangladesh, Nepal and Pakistan.

However, the success of these donor-led tax reform agendas was largely determined by political commitment to the reforms. Our case studies indicate that the urgent need to increase tax revenues may temporarily strengthen domestic commitment by creating a shared sense of the inevitability of tax reforms across the spectrum of relevant stakeholders. This was critical for enabling donor-supported tax reform to overcome political economy hurdles.

This tends to corroborate the analysis by Crivelli and Gupta (2016), which finds that revenue conditionality does matter for promoting tax reforms, particularly for LICs where revenue ratios are below the group average. Their research, however, also signals that revenue conditionality makes no difference to revenue performance where levels of corruption are high. As illustrated in section 4.2.2, corruption among political and economic elites significantly influences the political economy dynamics of tax reforms in the case study countries.

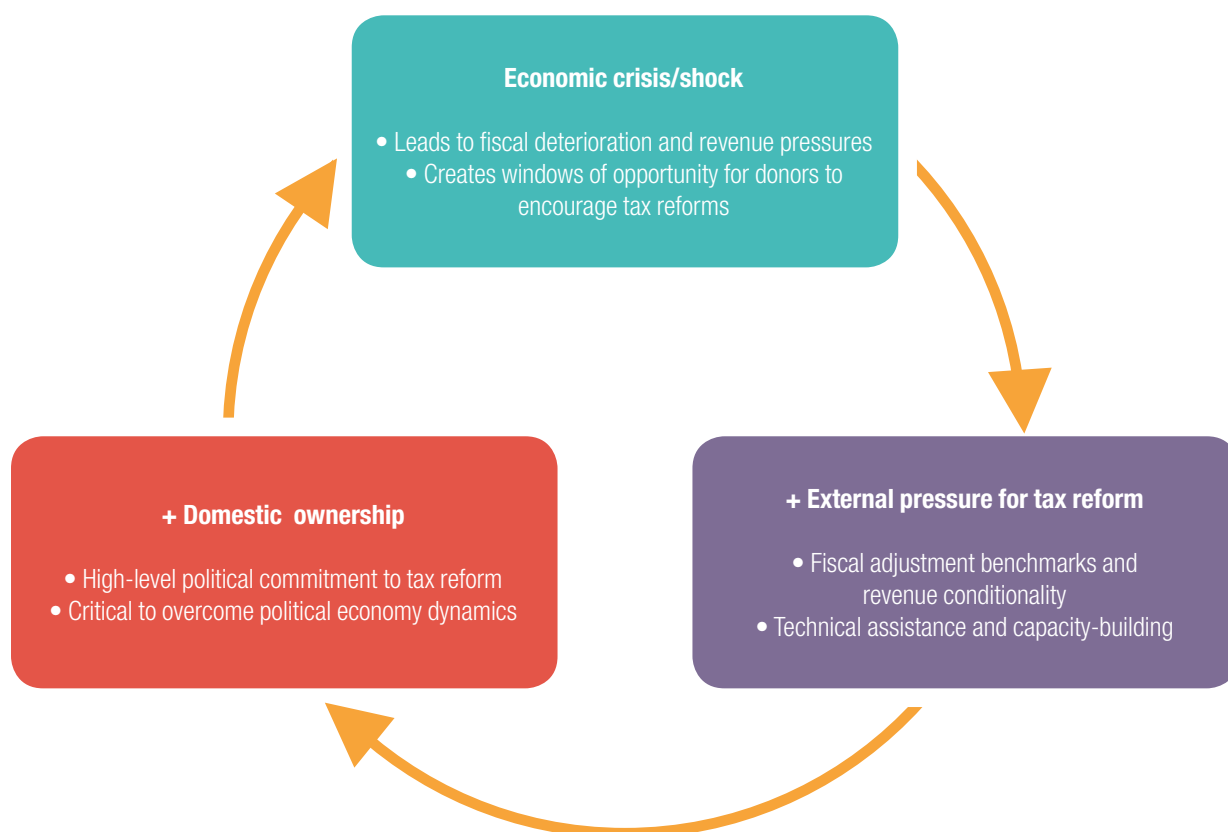
A lack of political commitment, on the other hand, is associated with reform disappointments and failures. These findings are consistent with an evaluation of World Bank support to tax system reforms globally over the period 2005-15, which concluded that its support encountered significant backtracking and political opposition (World Bank, 2017).

- In Bangladesh, the absence of domestic ownership and supportive reformers resulted in the government significantly watering down the implementation of the 1991 donor-led VAT reform (Hassan and Prichard, 2016).
- In Pakistan, the waning trust of the public in donors' ability to design tax reforms makes potential future donor-assisted programmes more difficult to implement. Pakistan's mixed success on tax reforms is seen as a donor failure; donors are criticised for designing programmes that create tax burdens with no apparent

12 Based on data from the Standardized World Income Inequality Database.

13 However, it is worth noting that the Commitment to Equity Institute has completed a tax and benefit analysis for Indonesia and is in the process of completing the same for India and China.

Figure 14: Revenue pressures create windows of opportunity for donors to encourage tax reforms in partner countries



benefit. At the same time, the World Bank’s TARP completion report described both the results and the performance of the government over the lifecycle of the project as ‘unsatisfactory’.

In addition, Crivelli and Gupta (2017)¹⁴ find revenue conditionality in IMF-supported programmes to be effective in offsetting potentially negative impacts from foreign aid on tax collection. They find the impact is stronger for countries where aid dependence is high and where institutions are strong – suggesting that revenue conditionality cannot substitute for weak institutions in mitigating the negative effect of aid on tax revenue collection. This nuances Dreher’s (2005) findings that participation in IMF Stand-By and Extended Fund Facility arrangements improves fiscal policy, yet compliance with conditionality has no systematic influence.

Furthermore, lack of efficient donor coordination and collaboration can undermine the impact of capacity-building of tax systems.

- In Pakistan, the predominance of the IMF and the WBG in the management of the reform process shut out support from some bilateral donors. Even DFID’s involvement was at the request of the World Bank – to provide support for some tax administration reform actions which had to be implemented outside the World Bank-funded Tax Administration Reform Program. However, DFID remains a significant driver of the

reforms through its financing of the associated trust funds.

- Lack of leadership and coordination among donors delayed Nepal’s revision of its Direct Tax Code.
- In contrast, in Bangladesh, a tax development partner group (chaired by the IMF resident representative) was convened in February 2013 to begin to align bilateral support around the IMF-led Tax Modernisation Plan.

4.3.2. Political transitions or shifts in power may unlock political economy stalemates to tax reform

In Indonesia and Pakistan, newly elected governments and heads of state have supported tax reforms in an effort to appear reformist or mark a change with the previous regime. This concurs with Brys (2016), who argues that new governments that have campaigned for election on a reformist agenda can use their electoral mandates to make rapid progress, including on tax reform.

- Indonesia’s initial tax administration reform (2000-2003) followed changes in the political landscape. When Megawati became president after former President Wahid was impeached, she presided over a broad but precarious coalition. To make herself electable she needed to pursue a reformist agenda without upsetting the various coalition interests. Limited reform of the notoriously corrupt tax administration was the least contentious option.

14 Their research applied to 111 low- and middle-income countries between 1993 and 2012.

- Indonesia's current government resorted to a tax amnesty programme in 2016 to meet short-term financing needs to fulfil its electoral promise of upgrading the country's infrastructure. This one-off tax measure enabled the government to overcome binding budget constraints following the end of the commodity boom.
- In 2013, Pakistan had its first democratic transition – from the Pakistan People's Party to the Pakistan Muslim League-Nawaz (PML-N). The PML-N manifesto proposed many tax reforms to increase revenue collection, which were then incorporated into the Federal Board of Revenue's strategy. Implementation is ongoing.¹⁵

In Bangladesh and India, unexpected domestic political developments have weakened long-standing opposition to tax reforms:

- In Bangladesh, opponents of tax reform (and their informal networks) were unexpectedly weakened when their strongest ally within the Prime Minister's Office was abruptly removed from his post in response to allegations of corruption. This change empowered the comparatively reformist Minister of Finance to push for policy changes that had been strongly resisted by the NBR in the past. This opened the door for the modest renegotiation of existing rules governing the tax system (Hassan and Prichard, 2016).
- In India, the passing of the landmark GST reform in May 2017 was made possible by clever political bargaining by President Modi during a period of declining public support for the opposition Congress party. As the largest party in the Upper House (which represents the states), Congress had previously blocked the GST reform, along with Modi's land acquisition bill. This tactic lost Congress support at the state election. President Modi was then able to convince states to support the GST reform in the Upper House by accepting their request to compensate revenue losses for five years after the reform.

4.4. Political dynamics complicate regional tax cooperation

The countries covered in this study are part of three sub-regions in Asia: South Asia (Bangladesh, India, Pakistan and Nepal), Southeast Asia (Indonesia) and East Asia (China).¹⁶ Regional cooperation is structured around

these sub-regions, with the most significant regional groupings being the South Asian Association for Regional Cooperation¹⁷ (SAARC) and the Association of Southeast Asian Nations¹⁸ (ASEAN).

Both these groupings are developing closer economic ties, including closer cooperation on tax policy. ASEAN has proceeded further, establishing an ASEAN Economic Community (AEC) in 2015. The AEC Blueprint 2025¹⁹ sets out the vision for economic integration over the next decade, and includes the following tax-related measures:

- **Bilateral tax agreements:** support the completion and improvement of a network of bilateral tax agreements to address the double taxation problems, and work towards the enhancement of withholding tax structures, where possible, to promote the broadening of the investor base for ASEAN debt issuance.
- **Exchange of information:** improve the implementation of exchange of information in accordance with international standards.
- **Base erosion and profit shifting (BEPS):** discuss measures to address these issues to ensure fiscal health.
- **Global taxpayer identification:** explore the possibility of a global taxpayers' identification number to improve tax collection and enhance the monitoring of transactions.
- **Excise taxation information sharing:** explore the possibility of collaboration in excise taxation and information sharing among ASEAN member states on common excisable products.

Within ASEAN, action towards these objectives is to be coordinated through the ASEAN Forum on Taxation, made up of the heads of tax authorities. The February 2017 AEC 2025 Consolidated Strategic Action Plan²⁰ did not set out any further actions on taxation, but indicated that this was to be taken forward by a Strategic Action Plan 2016-2025 for ASEAN Taxation Cooperation – which was reportedly adopted at the 30th ASEAN Summit in April 2017.²¹

The ASEAN Forum on Taxation is complemented by the Study Group on Asian Tax Administration and Research (SGATAR), which has a broader membership extending to East Asia and the Pacific.²² It has some similar areas of focus – BEPS, multinational enterprise risk, information sharing, tax transparency, SME compliance and taxpayer service – but generally a greater emphasis on

15 Conversely, political changes in 2008 may have made it more difficult to implement tax reform.

16 The Annual IMF–Japan High-Level Tax Conference for Asian Countries is perhaps the only forum that brings all Asian countries together for discussions on taxation.

17 Afghanistan, Bangladesh, Bhutan, India, Maldives, Nepal, Pakistan and Sri Lanka.

18 Brunei, Cambodia, Indonesia, Laos, Malaysia, Myanmar, Philippines, Singapore, Thailand and Vietnam.

19 http://www.asean.org/storage/2016/03/AECBP_2025r_FINAL.pdf

20 <http://asean.org/storage/2012/05/Consolidated-Strategic-Action-Plan-endorsed-060217rev.pdf>

21 <https://www.asean2017.ph/chairmans-statement-30th-asean-summit/>

22 ASEAN members Brunei, Lao PDR and Myanmar are not SGATAR members. SGATAR's membership also extends to East Asia (China, Japan, Mongolia, South Korea and Taiwan) and the Pacific (Australia, Papua New Guinea and New Zealand).

administration.²³ Unlike other regional bodies, such as the African Tax Administration Forum and the Inter-American Center of Tax Administrations, SGATAR does not have a permanent secretariat, which may account for its relatively low profile. However, in 2013, it established a rotating ‘taskforce’ consisting of the previous, current and future chairs, which functions as a secretariat.

SAARC has made less progress on tax cooperation than the Southeast Asia region. This largely takes place through the SAARC Finance Ministers Group meetings. The areas of focus²⁴ are considerably less ambitious than those covered in the ASEAN agenda, and focus on tariff reduction, customs harmonisation and avoidance of double taxation:

- Strengthening regional trade through implementation of the South Asian Free Trade Agreement, including reducing tariffs, eliminating non-tariff barriers and para-tariff barriers and reducing the number of items on sensitive lists for which there is no tariff reduction.
- Harmonisation of customs procedures and documentation in the region to facilitate movement of goods across borders.
- Initiating a discussion on widening the scope of the SAARC Agreement on Avoidance of Double Taxation

and Mutual Administrative Assistance in Tax Matters to include tax information exchange.

These groupings are summarised in Table 6. As shown, there is no regional tax administration body that covers the whole of South Asia. In general, Asia (and South Asia in particular) is relatively poorly networked in terms of tax policy and administration. ASEAN’s engagement on tax policy has been limited but now appears to be increasing with the recent adoption of a ten-year Strategic Action Plan for Taxation Cooperation. A key issue for SGATAR, the wider Asia-Pacific regional body, will be how to evolve when many of its members are pursuing closer tax cooperation under the ASEAN umbrella. It could either seek to be a bridge between the Southeast Asia, East Asia and Pacific regions – although the largest economies (Australia, China, India, Indonesia and South Korea) are all G20 members and may prefer to pursue cooperation through that forum – or it could seek to become more of a peer learning network with a narrower technical focus (e.g. on issues such as SME compliance and taxpayer service improvement), rather than on larger policy issues such as BEPS and exchange of information.

Table 6: Tax cooperation in Asia

Forum	Membership	Areas of focus
ASEAN Forum on Taxation	Tax authorities of the ten ASEAN members	<ul style="list-style-type: none"> • Bilateral tax agreements • Exchange of information • BEPS • Global taxpayer identification • Excise taxation information sharing
Study Group on Asian Tax Administration and Research (SGATAR)	Heads of tax administrations from 17 members across the Asia-Pacific region*	<ul style="list-style-type: none"> • BEPS • Multinational enterprise risk • Information sharing • Tax transparency • SME compliance • Taxpayer service
SAARC	Finance ministers of the eight SAARC members – informal meetings of the SAARC Finance Ministers are being held on the sidelines of Asian Development Bank Governing Board meetings	<ul style="list-style-type: none"> • Tariff reduction • Harmonisation of customs procedures • Double taxation • Exchange of information
IMF South Asia Regional Training and Technical Assistance Center (SARTTAC)	Bangladesh, Bhutan, India, Maldives, Nepal and Sri Lanka	<ul style="list-style-type: none"> • Promotion of better tax systems • Peer exchange

* *Australia, Cambodia, People’s Republic of China, Chinese Taipei, Hong Kong SAR, Indonesia, Japan, Macao SAR, Malaysia, Mongolia, New Zealand, Papua New Guinea, Philippines, South Korea, Singapore, Thailand and Vietnam.*

23 More generally, a report to the G20 (IMF et al., 2011) found that regional tax groupings are typically focused more on administration than on policy, and vary in their resourcing, activities and breadth of focus. Other regional organisations include: the African Tax Administration Forum, the Association of Tax Authorities of Islamic Countries, the Commonwealth Association of Tax Administrators, the Inter-American Center of Tax Administrations, the Centre de Rencontres et d’Études des Dirigeants des Administrations Fiscales, the Forum on Tax Administration, the Intra-European Organisation of Tax Administrations and the Pacific Islands Tax Administrators Association.

24 As identified at the Eighth Meeting of SAARC Finance Ministers, held in Islamabad on 26 August 2016. See http://saarc-sec.org/areas_of_cooperation/area_detail/economic-trade-and-finance/click-for-details_7

In South Asia, SAARC frequently struggles to function effectively given the tensions between its two largest member states (India and Pakistan). A key challenge in promoting further regional cooperation will be how to handle this issue. The SAARC Finance Ministers Group has made some tentative progress on addressing tax policy issues, and it may therefore be more worthwhile encouraging the group to take on issues such as BEPS and information sharing. However, given the tensions within South Asia, India may prefer to engage on these issues with other leading economies through its membership of the G20 rather than with smaller regional economies.

There is no regional tax administration organisation in South Asia that can act as a peer learning network and help formulate joint challenges, as in other regions of the world. This is a particularly important ‘gap’ for the major DFID-client countries: Bangladesh, Nepal and Pakistan.²⁵ This gap could potentially be filled by the recent establishment (in February 2017) of the IMF South Asia Regional Training and Technical Assistance Center (SARTTAC) in Delhi. One of its areas of focus is better tax systems, and it also aims to encourage regional peer exchange and networking across the South Asia region (IMF, 2017b). However, the difficulties of working across South Asia are reflected in the fact that Pakistan is not a member of the organisation.²⁶

25 Note that for Myanmar, which is not covered in this study, a better course of action would appear to be to join SGATAR, as that fits better with its membership of ASEAN, and on the expenditure side with its membership of the Public Expenditure Management Network in Asia, which is also focused on East and Southeast Asia.

26 SARTTAC member countries are Bangladesh, Bhutan, India, Maldives, Nepal and Sri Lanka. It is supported by Australia, the EU, South Korea and the UK as well as by its member states. See <https://www.sarttac.org/content/sarttac/en1.html>

5. Implications for scaling up support to tax reform

Key findings

- International assistance can make positive contributions to tax reforms, but attribution is challenging.
- For maximum impact, capacity-building efforts for tax systems in difficult political economy contexts need to be creative and pragmatic in adapting to the prevailing local political environment and must encourage national commitment to tax reforms.
- Strengthening the capacity of local actors (businesses, the media, civil society organisations) –including anti-corruption measures in support of programmes and the creative use of disbursement conditionalities – can foster broad-based domestic coalitions committed to tax reform.
- Combining opportunistic, short-term capacity-building for ‘quick wins’ with medium-term reform strategies can demonstrate the value of reform, and sustain support and momentum. Scaling up in the short term to support emerging opportunities for reform requires external actors to remain engaged on an ongoing basis.
- Successfully building tax administration capacity is critical and requires long-term engagement with strong buy-in from senior management.
- External actors should foster regional cooperation, both as a means of promoting better tax systems and of maintaining ongoing engagement with tax authorities.

The political economy analysis in section 4 highlights the critical importance of both domestic commitment for successfully implementing tax reforms and the influence of pervasive political economy dynamics on tax reform outcomes. Successfully building the capacity of tax systems in difficult institutional environments may therefore require several complementary approaches, depending on the extent of domestic support. These approaches include strengthening domestic commitment to tax reform, adapting tax reforms to the prevailing local political environment, building capacity in the tax administration, supporting local capacity for tax analysis and fostering regional cooperation. The remainder of this section addresses these in more detail.

5.1. Bolster domestic commitment to tax reforms

The political economy analysis highlights the fact that domestic commitment is a prerequisite for successful donor-led tax reforms. Donors should therefore include support measures which encourage broad-based coalitions for tax reforms. Tax reforms are not only technical but also political, and there needs to be a recognition that public opinion and government support for these reforms may fluctuate over the lifetime of projects (World Bank, 2017). Successful tax reforms in multiparty democratic regimes, such as India and Indonesia, have depended on existing domestic political momentum as well as skilled political leadership.

In addition, recent studies indicate a link between citizens’ tax morale – the public’s perception of tax matters – and perceptions of the quality of social expenditure (OECD/ECLAC, 2011). The widespread perception within Pakistan that government spending is inefficient, for instance, reduces citizens’ willingness to pay tax (Cyan et al., 2016). This implies that strengthening government accountability for delivering quality public service may improve the public’s tax morale and eventually lead to a virtuous circle, where compliance with increasing tax obligations is seen as an appropriate price to pay for ‘civilisation’ (Aiyar and Pritchett, 2015). Perception-based evidence also shows that people have a lower tendency to justify tax evasion or to think that taxes are too high when they are satisfied that democracy works, that corruption is low, that public services are of good quality and when they feel safe and trust each other (OECD, 2012). Empirical findings from Torgler (2004) further suggest that trust in government and legal institutions and satisfaction with national officials also have a significant positive impact on tax morale in Asian countries.

Specific recommendations emerging from the case studies for bolstering domestic commitment to tax reforms include the following:

1. **Encourage broad-based coalitions for tax reforms.** Build the capacity of local stakeholders, including civil society organisations, the press and other relevant, functioning supporting institutions and organisations outside the revenue system – such as the judiciary, parliament and supreme audit institutions (World Bank, 2017). These

groups are key to shaping and informing public debate, and holding governments to account, and can both support and unblock tax reform efforts (World Bank, 2016b). Viable and politically relevant ‘champions’ play an important role in explaining reforms to taxpayers, the media and civil society (World Bank, 2010). India’s Minister of Finance, for example, played a crucial role in brokering consensus around the 2017 GST reform.

2. Develop a culture of paying appropriate taxes.

Incorporate specific awareness-raising modules into capacity-building efforts for tax systems. These could include programmes for public information, taxpayer education and public–private dialogue. Taxpayer education needs to go beyond the narrow objectives of increasing revenue or explaining why taxes should be paid. Rather, it needs to emphasise the returns on taxes that citizens can expect, by demonstrating how they support public expenditure and the common good. Taxpayer education campaigns can also be an efficient and effective way of building trust and increasing public engagement in tax reform (OECD, 2015). GIZ’s successful approach to educating taxpayers in Nepal involved wide-reaching, informative educational campaigns, which included a ‘taxpayer education toolbox’, manuals on interpreting tax law, comprehensive brochures on a range of tax issues and TV publicity.

3. Explore more creative use of graduated funding mechanisms with practical and meaningful revenue-related triggers. Variable tranches or cash-on-delivery arrangements that target actions that are effectively under the control of the tax authorities can yield valuable dividends for governance or statebuilding (Birdsall and Savedoff, 2010). While government ownership is a crucial prerequisite for politically sensitive tax reforms, external actors can play an important role in opening up space for reform through lending conditionalities. Assertive use of funding conditionalities by the IMF was instrumental in ‘pushing’ the Government of Bangladesh towards a new VAT law in 2012.

4. Include anti-corruption measures in support of tax reform. Support civil society organisations and researchers working on the anti-corruption agenda, and support countries’ efforts to build capacity in fighting tax evasion, money laundering and corruption. Efforts to fight corruption, to enhance security and the legal system, and to make the state more responsive to citizens’ wishes are all associated with higher tax effort (Langford and Ohlenburg, 2016). The perception of corrupt tax administrations in Bangladesh, Nepal and Pakistan weakens citizens’ tax morale, undermining efforts to improve voluntary tax compliance.

5.2. Adapt tax support to difficult institutional environments

The experiences covered by the case studies indicate that purely technocratic reforms that do not consider the domestic political dynamics are likely to underperform. In Bangladesh, tax reforms that sought to dramatically alter the tax administration and thus threaten the political logic of the tax system have been strongly resisted (Hassan and Prichard, 2016). The case studies point to the following approaches to mitigate the negative impact of political economy dynamics on support to tax reform:

- 1. Customise tax reform support to fit country-specific economic, structural, cultural and political conditions.** This requires proactively assessing and monitoring changes in the country’s economic fortunes and/or shifts in the domestic political balance to identify ‘windows of opportunity’ for reform (Prichard et al., 2012). It also requires a thorough understanding of the country’s political-bureaucratic context to better identify the incentives and constraints that underlie reform dynamics, based on up-to-date political economy analysis.
- 2. Develop opportunistic and pragmatic reform coalitions around specific tax reforms.** To address potential opposition to concrete tax reforms, donors can focus on supporting reform coalitions, made up of a core group of actors within and outside government, centred around specific tax reform objectives (Booth, 2014). Such coalitions may address the coordination problems that normally afflict broad-based campaigns, make tactical decisions about how to divide the opposition, and make alliances without the need for consensus (other than on the reform objective itself).
- 3. Adopt a results-based approach.** Focus on ‘results’ rather than ‘inputs’ by setting up robust ‘results chains’ to ensure that key results are achieved, and to disseminate the basics of a results-based culture in the tax administration. A results-based approach also provides flexibility during implementation, allowing room to address the political economy challenges that may emerge over the course of the project. To overcome bureaucratic resistance, the Government of Bangladesh requested World Bank support in setting up robust results chains to ensure that the key results of tax administration projects are achieved. This also included introducing a results-based culture in the tax administration.

5.3. Strengthening tax administration capacity is a priority

Case studies identify weak tax administrative capacity as a binding constraint to further enhancing tax collection. Strong patronage and clientelist networks obstructed governance-related reforms of the tax administrations in Bangladesh and Nepal. In Pakistan, the slow pace of implementation of functional reforms in regional offices

obstructs revenue collection. Mitigating the institutional impacts on tax administration reform requires the following actions:

1. **Support diagnostic assessments to identify country-led priority areas and binding constraints for tax administration reforms.** The IMF's Tax Administration Diagnostic Assessment Tool allows tax authorities to identify and focus on the most binding constraints, to produce quick results and strengthen consensus around tax administration reforms. The way these assessments are conducted and how their results are used matter. To avoid the perverse consequences of using ratings as an end in themselves, reforms should focus on how systems function rather than their form (Hadley and Miller, 2016).
2. **Secure buy-in from senior management for organisational reform of the tax administration.** The bureaucracy maintains a long view despite regular turnover (as the same people are often reshuffled and return to the same posts) and can pursue projects involving administrative strengthening. This implies that reforms need broad endorsement from the bureaucracy to maintain support when staff are reshuffled.

Support from the bureaucracy enabled Nepal to successfully reform its administration's IT systems. In the absence of concrete and visible support from the tax administration's senior management, donors should pursue more pragmatic reforms to improve tax systems at the margins, as was done in Bangladesh – for example, the NBR has introduced taxpayer identification numbers, expanded online tax filing, introduced alternative dispute resolution for tax disputes and expanded the tax net for small firms through innovative measures like tax fairs (Hassan and Prichard, 2016).

Tax reform projects should be designed and led by senior management with input from donors, rather than the reverse. Donor-supported tax reforms that senior management do not prioritise or may not fully agree with are not sustainable in the long run.
3. **Adopt a longer time frame for reforms to tax administration.** The Bangladesh case study and GIZ's evaluation of donor support (2003) for Nepal conclude that a short time frame is incompatible with the implementation of major tax administration reforms. In practice, the organisational restructuring and modernisation of a country's tax administration may require a more gradual, piecemeal approach and a long-term perspective.
4. **Recognise that many important tax administration reforms do not maximise revenue in the short run.** Taxpayer education that targets future taxpayers through the education system (e.g. secondary and university students) is a good example of a reform initiative that has few short-term returns but may have long-term benefits for tax morale.

5.4. Build local capacity for tax policy analysis and expand the knowledge base on tax reform in Asia

The literature review for the case studies reveals the lack of recent, country-specific analysis and research on the political economy of tax reforms and on the role that international assistance played in supporting tax reforms in Asia. Addressing these gaps requires the following approaches:

1. **Capacity-building for locally-led, country-specific research and analysis.** This would underpin a more holistic approach towards tax systems in the region by including fiscal incidence analysis of tax policy reforms, increase transparency through tax expenditure analysis, mitigate political economy dynamics through political economy analysis and address gender biases in the tax system.

This also requires building capacity to develop comparable revenue statistics. These can facilitate transparent tax policy dialogue and provide policy-makers with the data necessary to assess alternative fiscal reforms and make relevant policy recommendations for countries in the region. Accurate data on the 'tax mix' is important for designing tax reforms due to the varying effects of different types of taxes on economic growth and income distribution.
2. **Supporting an 'evaluation culture'.** While there is evidence that donors have made important contributions to tax reforms in the region, attribution is challenging. By systematically including evaluations in support programmes, donors can better identify and disseminate lessons learned for tax reforms.
3. **Fostering regional cooperation on tax matters.** As discussed in section 4.4, regional cooperation is difficult to achieve in South Asia. Yet issues such as avoiding tax competition and harmonising tax rates, exchanging information on cross-border capital flows into tax havens, tackling illicit transfers of funds and signing double taxation agreements are no less important than in other regions (UNESCAP, 2014). Despite regional tensions, SAARC has made some progress on tax policy matters such as avoidance of double taxation and exchange of information. Given the Asian Development Bank's work in supporting regional integration, its role in supporting further progress could be explored. Section 4 also noted the absence of a dedicated regional tax organisation to promote peer learning and evidence-based discussions, based on accurate data and analysis. The recent establishment of the IMF SARTTAC provides a potential avenue for pursuing such activities.
4. **Promote further research.** This study finds gaps in the literature with respect to both the gender dimensions of tax reform (see Annex 1 for more on this) and the distributional impact of tax systems in the case study countries.

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Annex 1: The gender dimension of tax reforms

There is scope for policy-makers and analysts to shape tax policies to both raise revenue and address gender inequalities. This requires legislative action to eliminate explicit gender biases emanating from the tax system. Redesigning the structure of exemptions and deductions in personal income taxes can mitigate gender inequality. Indirect taxes can often be made gender-equitable by including exemptions and zero-rating of basic consumption goods, which are disproportionately consumed by women.

The scope of this study did not allow for a thorough investigation into issues of gender bias in the tax system. Within the literature reviewed in the course of the study there was no coverage of the gender impact of tax reforms, with the exception of India. India has an explicit bias in favour of women: they have a higher threshold for Personal Income Tax, so they can accrue a higher proportion of income before starting to pay tax. However, this has limited impact since it affects only a small minority of women working in the formal sector. The VAT in West Bengal was found to be regressive for women, especially those in low-income households – see UNDP (2010) and Chakraborty et al. (2010).

Despite our case studies' lack of findings on the gender dimension of tax reforms, the issue seems worthy of further consideration and research. While Stotsky (1997) notes that 'the tax code in Pakistan discriminates in favour of women by allowing a basic exemption that is higher for a working woman than a man, and the tax code in India also contains provisions favouring women', implicit forms of gender bias may potentially have evolved due to the predominance of women in micro and small businesses, resulting in a disproportionate tax burden on female entrepreneurs.



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