



# “Fiscal Corruption: A Vice or a Virtue”—A Reply

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## 1. APT INTERPRETATIONS AND APT CONCLUSIONS

Interpretation of other people’s work always runs the risk of becoming misrepresentation, and Chand, Moene and Mookherjee certainly seem to think that this is the case in our paper “Fiscal corruption: A vice or a virtue” (this issue). In particular, they reject an interpretation of their papers “as advocating incentive reforms as a way of stimulating more corruption, which may have the *side effect* of increasing short run revenues.” But this view has never been suggested in our work, and it is hard for us to understand how our comment can be (mis)interpreted in this way. We certainly acknowledge that Chand, Moene & Mookherjee, in this and previous work, have made important contributions to the understanding of the *vices* of corruption, and hence there is no basis for claiming that they are ignorant of the importance of this problem.

It is the case however, that both Mookherjee (1997) and Chand and Moene (1999), *among other things*, outline a mechanism which shows that incentive reforms may increase tax revenues by strengthening the bargaining power of corrupt tax collectors (which in this context is the same as saying that they get a higher bribe from companies caught in tax fraud). This is an important and intriguing paradox. But what should we make out of it? In order to answer this question, we agree with Chand, Moene & Mookherjee that it is essential to distinguish between descriptive and normative statements. To outline a mechanism of this kind does not at

all imply that one ought to support incentive reforms. In general, there will be many mechanisms at play and several aims to consider. Hence, it is necessary to take a broader view in order to reach apt conclusions. This is particularly important within economics, where we narrow most problems substantially in order to attain precise knowledge about a specific aspect of society by using formal models.

Our main claim is that if we analyze this paradox in a broader framework, then we should seriously doubt whether *this particular* mechanism should make us more supportive of incentive reforms. Our conclusion is not due to a deontological obsession with corruption, but reflects the view that we doubt that the paradox is robust in a long-run perspective. Moreover, this conclusion becomes even more plausible if we encompass a broader set of aims in the analysis and assign intrinsic disvalue to the presence of corruption.

## 2. MEANS AND ENDS

Chand, Moene & Mookherjee suggest that there is an obvious answer to the question raised in the title of our paper; to wit that we all agree that fiscal corruption is a vice and not a virtue. But what does this mean?

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Consider the following passage in Mookherjee (1997, p. 16, our emphasis), which actually inspired our title:

In the model presented here the *virtues* of allowing corruption are twofold. First corruption provides some incentive for taxpayers to comply with taxes, since the prospect of collecting bribes motivates tax collectors to devote their effort to audits. . . Second, recognizing that tax collectors are expected to collect bribes from taxpayers, the government can pay its collectors lower wages.

Within this setting, Mookherjee (1997, p. 14) argues that

Increases in the bonus rate increase the bribe level. . . This in turn increases the private benefit to the tax collector from monitoring more intensively, which increases the private cost to the tax payer of evading taxes. Hence, in this case, increased corruption is *useful* in limiting tax evasion.

It is impossible for us to read this in any other way than saying that fiscal corruption can be virtuous as a *means* in certain settings. However, this is not inconsistent with viewing fiscal corruption—or corruption in general—as a vicious *end*, which seems to be what Chand, Moene & Mookherjee have in mind when they suggest that there is an easy answer to our question. Notice, however, that this is not a trivial statement to make within standard welfare economics. Welfarism is the prevailing view among economists, and within this framework there is no room for assigning intrinsic disvalue to corruption beyond how it affects the welfare of people. In practice, this may not be an essential distinction, because, as pointed out by Chand, Moene & Mookherjee, most (all?) people do assign value to reducing corruption, and hence its presence will in itself affect their welfare. But this fact seems often easily forgotten in economic analysis. As an example, it is worth noting that Mookherjee (1997, p. 14) does not include the extent of corruption in the measure of social welfare used in the discussion of incentive reforms. Moreover, on two instances, Mookherjee (1997) states explicitly that “eliminating corruption is not an end in itself” (p. 6 and 16). One can therefore easily get the impression that reducing fiscal corruption is virtuous only if it contributes to some other intrinsically valuable aim. Thus, it should be appropriate to remind ourselves of the fact that reducing corruption *in itself* should be considered valuable.

### 3. TRADEOFFS

Chand, Moene & Mookherjee suggest that the main aim of our paper is to defend the view that corruption *per se* is undesirable. This is not the case. Our main concern is the *nature* of the tradeoffs faced by policy makers. In practice, it is very hard to delineate a very precise picture of society. Thus, as economists we mainly end up sketching ways of thinking about these tradeoffs when evaluating reforms. One sketch we have a problem with when debating incentive reforms in general or bonus schemes in particular is the idea that we should manage to sustain an increase in tax revenues by strengthening the bargaining power of corrupt tax collectors. This does not imply that we reject bonus schemes or incentive reforms out of hand. In the presence of both corrupt and noncorrupt tax officers, for example, incentive reforms may increase both corruption and tax revenues. Consequently, we face a real tradeoff and no easy answer.

In our discussion of the link between fiscal corruption and tax revenues more generally, we portray two vicious circles. On the one hand, *fiscal corruption* may reduce people’s willingness to pay taxes; on the other, it may weaken a commitment to honest behavior in the tax administration. Chand, Moene & Mookherjee suggest that in this discussion we overlook the distinction between corruption characterized by “cooperative collusion” and corruption characterized by conflict. But they fail to explain why this is of any particular relevance in the present context. Moreover, they also suggest that we are inconsistent in this discussion, by overlooking our own argument in the first part of the paper saying that incentive reforms may increase the ratio of honest to corrupt tax collectors. This is however, a misreading. Discussing effects of fiscal corruption is *not* the same as discussing effects of incentive reforms.

In debating the nature of these tradeoffs it is also important to have in mind how we measure corruption. This is undoubtedly a hard issue, both conceptually and empirically. But it surprises us when Chand, Moene & Mookherjee argue that we use the wrong measure of corruption, to wit the bribe level. We agree that this is only one among several possible ways of measuring corruption, but it is *precisely* the one used by Chand, Moene & Mookherjee in their papers (and the one they also refer to in their comment)! Moreover, it is the appropriate one for the question at hand, because it reflects the

bargaining power of corrupt tax officers which is essential in our argument.

#### 4. THE NEED FOR A BROADER APPROACH

Chand, Moene & Mookherjee stress that a main message of their work has been the need for accompanying incentive reforms with broader institutional reforms to ensure that undesired side effects, such as fiscal corruption, be avoided. Both Mookherjee (1997) and Chand and Moene (1999) provide insightful discussions in this respect. But within such a broader framework, we would like to question whether the mechanism discussed really provides the most appropriate analytical input to the debate on how to reorganize tax administrations. Chand, Moene & Mookherjee

underline in their comment the value of demonstrating the minimum conditions necessary for a bonus scheme to be effective in raising revenue. But we are not convinced by this strategy in the present context. We think that this minimal version points to the wrong way of (eventually) defending incentive reforms, and hence is to some extent misleading for the present policy debate. We acknowledge however, that this is partly an empirical claim. Thus, a move forward on this debate will demand more detailed empirical investigation. We made a brief comment on the reform in Ghana, but accept, as pointed out by Chand, Moene & Mookherjee, that there is more to this story than what we suggest in our paper. More generally, this should be a most promising area of empirical research, given the many tax administrative reforms which at present are being implemented in developing countries.

#### REFERENCES

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