

Taxes and bribes: assessing the extraction burden in orderly and disorderly societies

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Countries with a low GDP per capita generally have a much lower fiscal quota than OECD countries, but many other factors push up the transaction costs in poor economies. High-tax societies provide more security, predictability and organizational discipline. The absence of such conditions is a powerful breeding-ground for corruption. If fiscal payments and bribes are added up to arrive at a composite measure of the 'extraction burden' in different countries, we might find that the costs of doing business do not diverge so much in various parts of the world.

Recently, a reporter working for *The Economist* made his own journey into the heart of darkness on a truck transporting 30 000 bottles of licence-brewed Guinness beer from Douala to Bertoua, a small town in Cameroon's south-eastern rainforest. When the vehicle reached its destination after four days on dismal roads, it had been stopped on 47 occasions and lost a third of its load. The roadblocks usually consisted of tyres or oil drums in the middle of the road. At each stop there were policemen checking passports and permits as well as the compliance with a variety of real or invented safety rules. At roadblock number 31, a gendarme found the driver guilty of breaking a ban on carrying passengers in trucks. When told that no such law existed, he patted his holster and replied: 'Do you have a gun? No. I have a gun, so I know the rules.'^{1,2}

This form of street-level corruption is familiar in large parts of the world. Underpaid rank-and-file officials have their own well-established technique of supplementing their meagre pay. Oscillating between severity and concessions, they zealously spot violations which are then graciously forgiven in exchange for suitable tokens of appreciation. In the higher echelons of the public hierarchy there

are analogous pendular movements between inertia and accommodation. First blockages, then breakthroughs as the appropriate contributions are offered to ensure that vital documents receive their appropriate stamps and signatures.

Let us now shift the scene to medieval Europe. A trader shipping his merchandise down the Rhine to the rich towns of the Low Countries was long exposed to a similar experience. Towards the end of the 12th century, duties had to be paid at 19 toll stations. A hundred years later the number had risen to 44, and at the close of the 16th century it was 62. Between Basle and Rotterdam, the distance between these stations did not exceed 10 km. Decade after decade, there were also quarrels about the legitimacy of the various tariff claims. While the traders demanded their freedom of passage, kings, princes, counts and bishops hurled fragments of Roman and canonical law at each other to prove the validity of their conflicting *iura regalia* or *iura domini*.^{3,4}

Another set of toll stations met the traders at city gates. Today, a German *Tor* or a French *octroi* or a Swedish *tull* is but an emblematic part of the urban architectural heritage, but for centuries these arrangements were crucial not only to the financial health of the cities but also to the survival of the early modern state, in which the royal–urban political alliance was an important political pillar. The freedoms granted to the burghers invariably included trading privileges, and repeated if not always successful efforts were undertaken to enforce the ban on rural commerce.

This fragmented customs system eventually gave way to expanding zones of free commerce: in the 19th century, the *Zollverein* and the integrated nation state, in the 20th century the various free trade areas and ultimately the European Community. Today's European truckers operate under conditions very different from those of their Cameroon colleagues. External tariffs have been homogenized. Within Europe, the passage fees levied here and there, on the French and Italian motorways, at the Swiss borders, and at the entrance of tunnels and bridges are strictly regulated and intended to cover the construction and maintenance costs. The recipients are either the various governments or publicly authorized corporations responsible for the management of particular routes. Corruption appears to be minimal in these systems of transit charges.

In comparing these various types of payment, one can observe a striking similarity. The common denominator on which all the claims are based is the strategic control of a vital passageway. The gatekeepers have a trump card in their hands, and the traders are normally prepared to pay a small sum or give up a small share of their merchandise in exchange for the coveted free passage. This bottleneck monopoly provides an excellent basis both for private gains, public levies, and a grey zone in between, which I propose to call *fiefs*.

The key message of this paper is that fiscal payments and bribes may in some respects be regarded as functional equivalents and that the combined load of these

two types of imposed payment may, from certain angles, be more interesting to examine than the fiscal quota alone. A focus on the cumulative 'extraction burden' may enhance our understanding of the *modus operandi* of different economies and the determinants for growth under different socio-economic and politico-cultural conditions.

As long as political economy has existed as an academic discipline, its practitioners have issued dire warnings about the baneful effects of high taxes. A century ago, the French economist, Leroy-Beaulieu suggested 12–13% of GDP as the absolute ceiling for government expenditures, and his Australian colleague, Colin Clark later proposed 25%. More recently, the Laffer curve has been launched as a reminder of the diminishing returns of increased taxes. Given everything that we now know about the dangers of steep imposition and the stifling impact of tax wedges, it is in fact surprising that advanced industrial states manage to survive and that some of them even exhibit respectable growth rates; it is equally astonishing that so many emerging economies do not seem to draw the predicted benefits from their low levels of taxation. Why is it that reality so stubbornly deviates from our theory-generated expectations?

A considerable body of literature has dealt with the ways in which various forms and types of public spending influence national growth rates.⁵ As far as taxes are concerned, there are few reasons to doubt that they impede economic expansion, and a principal question among scholars in the field of optimal taxation has long been to devise strategies of harm reduction. Collating evidence from both the expenditure side and the fiscal side of this research we might eventually make some inferences about overall policy optimization, but before that can be done it would seem wise to look also at non-fiscal compulsory or quasi-compulsory payments in orderly and disorderly societies.

Such 'shadow taxes' come in different guises. If a country decides to handle its social security needs through a regulated, obligatory private insurance system rather than a public or semi-public arrangement, this will, of course, lower the nominal fiscal quota without necessarily easing the burden of the employers. But everything depends on how you count. While Switzerland has long been a low outlier in European tax level diagrams with tax rates approaching those of the United States, a recent study claims that the Swiss fiscal quota is in fact the highest in Europe.⁶

A different type of 'shadow tax' is made up of the bribes that households and enterprises deem inevitable to offer, especially in poor and disorderly societies. These include not only payments for specific favours (passages, permits, etc) but also more generalized gifts common to clientelist systems. The sum total of such payments is exceedingly difficult to assess, and there does not seem to exist any reliable cross-national data on the actual size of bribes. But there is a wealth of studies on individual countries and economic sectors as well as indices on the

perceived levels of corruption, and this rich recent evidence may at least bring us closer to an assessment of the cumulative extraction burden.⁷

To approach this problem, we shall first take a look at the different types of fiscal receipts levied in various countries and then compare them to the typical forms of illicit payments made in connection with corruption.

The fiscal domain: a taxonomy of government revenue

To attain their goals, all government must mobilize resources from the territories under their control. Yet this objective may be achieved in several different ways. Four principal instruments in use are *tributes*, *tariffs*, *taxes* and *trade*, and most states operate with some mix of these that is largely conditioned by the level of economic development and the structure of economic transactions.⁸

Tributes is a source of government income typical of early and primitive political systems. It is a payment in cash or in kind, exacted *ad hoc* or at irregular intervals, often from collectives rather than individuals. Tributary relations tend to be less steady and more unpredictable than fiscal relations, but also more personal and emotional. Four examples may illustrate their role in early public finance.

- Tributes were an important source of government income in Antiquity. In the first Attic Sea League (from 478 BC), a levy called *phoros* was raised from towns that could not provide ships against the Persians. In Rome, a *tributum* was exacted from the citizens when need arose. This practice of purpose-defined specific contributions continued to be a mainstay of public finance through many centuries. ‘Aids’ were due on particular occasions, as when the lord went on a Crusade or had to pay for new lands. In the 13th century, Henry III of England tried several times to raise a general aid from his barons but met with flat refusals. To be legitimate, the tribute had to serve a distinct and customary objective, such as those specified in Magna Carta: ‘No scutage or aid shall be imposed on our kingdom except by common counsel of the realm, except to ransom our body, make our eldest son a knight, or marry our eldest daughter.’⁹
- In the late Middle Ages, Russia was controlled by the Golden Horde. Under this ‘Tartar Yoke’, Mongol officials were dispatched to all cities, but native satraps provided the rulers with most of the money, provisions and recruits that they required. No prince could assume authority without going to Sarai on the lower Volga to obtain an investiture charter called *iarlyk*. These licences were disposed of by

means of virtual auctions, in which the candidates had to make promises of future accomplishments. Although there were norms for what these vassals were expected to deliver to the ruler, there was also an element of caprice, uncertainty and discretion in their relationship. Oaths of fidelity and dutiful service did not always protect the servants from the whims of their masters. To remain in favour, they had repeatedly to reaffirm their devotion by excelling each other in bestowing gifts upon the ruler.¹⁰

- An important pillar of the Ottoman Empire was known as the 'boy tribute'. The system was introduced in 1432 under Murad II and developed further under his son Mehmet the Conqueror. Every three year or so an officer would be sent to the villages of Greece and the Balkans to select the finest Christian youths for the Sultan's service. After the march to Istanbul, the boys were sent to work on an Anatolian farm to build up their muscles and learn Turkish. After conversion to Islam and proper training, these recruits would be slaves of the Sultan for the rest of their lives.¹¹
- Tributes were particularly important in primitive tribes. 'Gift relations permeated the whole life of pre-exchange cultures', writes Gerloff. Gifts were transmitted on many occasions in the life cycle of the ruler and his family, such as births, manhood rites, weddings and funerals. They were also connected with fortunate events in the economic life cycle, e.g. the harvest, the division of war trophies, and the sharing of the booty from a successful hunt or fishing expedition. Gifts were made to chiefs but also to elders and other passive members of the community. In hunting tribes, particular parts of the animals were frequently predestined for the table of the chief. Among the Masai and Wakuafi, for instance, the chief had a legitimate claim to the breast and the right hindleg of any cow slaughtered for the holidays. When elephants and storks were killed by the Ondongas in Africa, the chief would get the ivory and the feathers.¹²

Tributes clearly belong to an early stage in the history of public finance, but the instrument has also been used much later, particularly in war-like and unruly situations. During the Second World War, occupation forces occasionally resorted to this type of collective levy to extract resources from communities under their control. In tributary relations, there are both voluntary gifts conveyed in the hope of averting sanctions or gaining favours from the recipient, and involuntary gifts exacted at gunpoint, in a figurative or literal sense.

Tariffs emerged as an attractive alternative to tributes already in Antiquity. In Athens, there was a *portoria* amounting to 2% of the commodities brought in. In the Roman empire, tariffs were paid both in the cities and at particular boundaries between colonies and areas. Duty collection was leased out to publicans who got their share of the receipts. Later on, in Carolingian times, the right to collect duties was, in many places, handed over to the church. Medieval tariffs tended to fall on imports, whereas later mercantilist duties were imposed mainly on exports. While the protective motive was often invoked to vindicate a tariff, it was clearly the generation of revenue that made rulers keen to develop and apply this instrument.

Before the rise of protectionism in the 19th century, tariffs were seldom high. As a rule, they lingered in the area of 2 to 5%. Nevertheless, they frequently met with circumvention and resistance, and many skirmishes and wars were fought over this form of imposition. In British history, there were in fact few wars that did not revolve around tariffs, with the American War of Independence (after 'the Boston Tea Party') as the most famous case in point. For many centuries of European history, town tariffs were also the chief source of revenue for local authorities. In Sweden, they were formally abandoned in 1810, but in other countries they survived much longer. The French *octroi* was introduced by royal privilege in 1647, and with a brief interval after the Revolution it remained a key instrument for financing urban government until the end of the Third Republic. It was finally suppressed in 1948 when French cities were allowed to levy local taxes instead.

The relationship between tariffs and trade has long fascinated economists and is fraught with tensions. Without external trade, no revenue from tariffs; with steep tariffs, no revenue from external trade. In tariff politics, there are frequent coalitions between government actors interested in public revenue and economic actors concerned with the protection of markets. But there are also frequent conflicts between governments with different capacities for fiscal extraction, as visible in the worldwide trade negotiations. The evidence that free exchange is beneficial to rich and poor countries alike has been compelling for over two centuries, but it still fails to convince regimes with weak alternative sources of public finance. Many regimes are built on fragile alliances in which political support for the centre is obtained only through far-reaching concessions to various agents in the periphery to impose tariffs, or tariff-like payments such as those exacted in Cameroon. Tariffs are particularly crucial in political systems where there is no stable taxation system in place.

Taxes are the predominant form of government revenue in mature states. Genetically, tax systems have developed out of tributary relations through the gradual routinization, individualization and homogenization of separate levies.

The transition process was often long and fraught with conflict. Gerloff traces an evolution from *Dargabe* and *Hergabe* to *Abgabe*. Grönbech reports an episode from early medieval Norway capturing the transformation. When the emissaries of the king tried to educate the peasants of Telemarken about their duty to pay taxes to the king, they met with a flat refusal from the proud northerners. 'We shall not pay taxes', said Asgrim from Fifiavellir, 'but we shall provide the king with friendship gifts'. Opulent loads were sent to the king, but he refused to accept them. 'Return all his gifts', said Harald, 'in this land I am the king and must determine what is right and law; me and not Asgrim.'¹³

Harald's line of reasoning was to prevail, not only in Norway but throughout Europe. The aids and temporary levies exacted *ad hoc* were step by step replaced by regular obligatory payments. But it took many centuries for the 'tax-paying habit' to strike root. In Sweden, the formal distinction between 'ordinary imposts' and 'extraordinary imposts' was maintained long after the latter had been integrated into the permanent fiscal system. In many European countries it was only in the decades preceding the First World War that taxes overtook tariffs as the main source of government revenue.

The physical basis of the developed tax state is an exchange economy that is highly monetarized. A low level of taxation is also possible in self-sustained agricultural economies, but until market transactions become frequent and money flows swell, the extractive capacity of the state will remain very limited. The transition to large-scale trade makes tax-imposition much more practicable and profitable, and the opportunities become even greater when payments are centralized and automated. Nowhere are money flows so easy and inexpensive to intercept as in the computerized economy.

The ideological basis of the Tax State is the recognition that the government has a justified claim to a fraction of such money flows. In this recognition, historical elements are closely intertwined with an appreciation of recent and current achievements. In contrast to tributes, taxes are recurrent, predictable, routinized and based on statutory obligations. Tax systems are composed of a great many different onera, normally named either after the basis of taxation (such as sales tax or income tax) or after the purpose for which the tax is levied (social security contributions, war taxes, solidarity taxes).

In the early stages of taxation, most levies were fixed charges on property and hence fundamentally static. Later, the assortment was extended to much more expansive variants, such as turnover taxes or proportional income taxes. Even greater yields were obtained through progressive taxes which, particularly under inflation, provided an automatic increase in government revenue through 'bracket creep'. Hinrichs has suggested that there is a characteristic sequence in the evolution of fiscal structures. In poor societies, there are crude levies from various social classes, usually based on the general taxable value of immovable property

rather than on its annual yield. In a second stage, more emphasis is placed on indirect taxes on trade, including tariffs. In a third stage, governments resort to progressive income taxes. In this sequence, the share of direct taxes to the total tax-burden follows a U-shaped curve: first the share begins to sink, then it comes close to the bottom and finally it starts rising again.¹⁴

A final important source of government revenue is made up of income from *trade*. Many governments obtain a small share of income from industry, commerce and services, and a few almost entirely rely on such sources. Government monopolies have a long history and have received particular boosts from the doctrines of royal absolutism, mercantilism and socialism.

Perhaps the most important public monopoly through the ages is that of the mint. The provision of standardized coins was immensely valuable to early commerce but also gave significant profits to many governments. Later on, the printing of banknotes became an inexhaustible source of public income. In periods of economic chaos, when the fiscal machinery was out of order, the printing press would even become the major instrument of resource mobilization. In the wake of the First World War, several countries in Central and Eastern Europe developed into trading states in which the survival of the government hinged mainly on their sale of printed paper-slips.

Trade monopolies have often had the dual function of yielding profits and facilitating taxation. Such an important source of income as the liquor tax, for instance, is hard to exploit unless the number of outlets is limited and under rigorous control. Governments in many developing countries had maintained foreign trade monopolies both to stabilize prices and to extract income. In Ghana, for instance, the post-war government managed to expropriate 40% of the proceeds from the cocoa export through a combination of export duties and the surplus of the Cocoa Marketing Board.¹⁵

In Communist countries, taxes played a relatively insignificant role while the bulk of government revenue was derived from enterprises in the guise of profits, turnover taxes and social insurance contributions. In Romania under Ceausescu, more than three-quarters of all government income were profits delivered to the state.¹⁶ In the OECD area, a substantial part of government income was long obtained from utilities until they were largely privatized in the 1990s. While trade normally generates profits to governments, it may also generate losses. The 19th century is replete with examples of 'political investments', mismanaged public enterprises, and public utilities operating with tax subsidies to serve distant regions and other social objectives.

The para-fiscal domain: extraction through bribes

Corruption is by no means limited to the public sector. Private enterprises are

Table 1. Perceived corruption across business sectors

How likely is it that senior public officials in this country would demand or accept bribes, e.g. for public tenders, regulations, licensing in the following business sectors?

Business sector	Score	Business sector	Score
Public works/construction	1.3	Heavy manufacturing	4.5
Arms and defence	1.9	Banking and finance	4.7
Oil and gas	2.7	Civilian aerospace	4.9
Real estate/property	3.5	Forestry	5.1
Telecommunications	3.7	IT	5.1
Power generation/transmission	3.7	Fishery	5.9
Mining	4.0	Light manufacturing	5.9
Transportation/storage	4.3	Agriculture	5.9
Pharmaceuticals/medical care	4.3		

The scores are mean averages from all the responses on a 0 to 10 basis where 0 represents very high perceived levels of corruption, and 10 represents extremely low perceived levels of corruption.

Source: Transparency International, *Bribe Payers' Index 2002* (14 May, 2002).

involved in it both as perpetrators and victims, and abuse of trust in different forms linked to side-payments by various third parties is a phenomenon prevalent in numerous settings. But it is nevertheless in the sphere of government that most cases of corruption occur. The archetypal bribe is a payment to a public official with the purpose of getting favourable treatment in a transaction involving government-controlled resources.

Since the bulk of the iceberg is solidly below the waterline, corruption is notoriously difficult to measure. In recent years, however, there has been considerable progress in research based on perception data, and respectable efforts have been made to construct indices of the prevalence of corruption across business sectors and countries. Table 1 presents a cross-national survey of perceived corruption tendencies in different industries. It comes as no surprise that such sectors as public works, military procurement, telecommunications, energy and real estate are ranked as particularly vulnerable to illicit payments. A size rule seems to operate: the larger the scope of an individual transaction, the more likely is it that stakeholders will use a broad spectrum of instruments to influence decision-makers. But the degree of transparency is also an important factor. Corruption flourishes in confidential settings and is highly sensitive to public exposure.

The side-payments made to influence strategic decision-makers are not all illegal. Towards the legal end of the spectrum there is a variety of transfers qualified as charity, sponsoring, donations in the public interest, campaign contributions, etc. There is also a broad central segment of payments for which the legal and moral ground may be regarded as uncertain and contestable. In economic settings where special emoluments are frequent, enterprises often invoke common practice to claim that they are compelled to play the game if they want to stay in it. Their constant justification is that 'everybody does it'. Further out towards the illegal end of the spectrum, there are lubricants that everybody involved recognises to be out of order. But even where this is the case, there is a clear though highly contestable tendency for businessmen to regard such expenditures as inevitable transaction costs.

Efforts to combat corruption have been intensified in recent years. In the OECD, 34 countries had, by February 2003, ratified the Convention on Combating Bribery of Foreign Public Officials in International Business Transactions. Within the Council of Europe, a monitoring mechanism (GRECO) has been set up to promote compliance with a set of recommendations and legal instruments including the Criminal Law Convention on Corruption, the Civil Law Convention on Corruption and the Code of Conduct for Public Officials.

Studies in comparative corruption have noted many similarities in bribery across national and economic boundaries. But how do bribes compare to different forms of fiscal payments? To what extent is it reasonable to qualify them as 'shadow taxes'? And if this is the case, can we detect areas of 'double taxation' where actors are obliged or choose to pay two masters, both the government and the illegal power structure supplementing it? To answer such questions, we shall return to the previous typology of government revenue to see whether there are corresponding categories of corruption-linked payments.

The kinship between the two zones is relatively obvious in the field of *tributes*. In political cultures characterized by clientelism, clients tend to express fidelity and submission to their patrons by bestowing upon them a steady stream of gifts and favours. In the novel and film *The Godfather*, the eponymous hero accumulates both wealth and clout through such contributions.¹⁷ In distinction to fixed-sum extorted payments, tributary gifts seem to serve the purpose of confirming faithfulness and affection. They are the *quid* in an exchange where the *quo* is significant but undefined – often a favour or concession expected some time in the future. This type of tribute is embedded in a structure of social relations where key elements are fear, honour, loyalty, obedience and indebtedness.

For the overwhelming majority of corruption-linked payments, the appropriate comparison in the fiscal field is the *tariff*. The bribe recipient is in command of

some asset or authority that enables him to facilitate or impede the briber's access to something valued, such as the passage into a country or out of a prison, the acquisition of a pardon or a licence, or the granting of an employment or a public contract. In most cases, the corrupt decision-maker is a politician or a government employee, but there are also analogous forms of abuse in industry and business where rules are bent or resources embezzled for individual gain. Private tariffs of this kind may be levied in isolation by corrupt individuals, but also in complex systems of acceptance and profit sharing.

In the vertically integrated pattern of corruption that is typical of many weak political systems, the superiors are perfectly aware of the widespread corrupt practices within their organization and accept it as a form of compensation supplementary to regular salaries and wages. The introductory Cameroonian example may well be a case in point. The politics of corruption in disorderly societies is often marked by double standards and a pendular movement between laxity and repression: at irregular intervals, the prevailing practice of looking through the fingers at the acquisition of 'private tariffs' is interrupted by short interludes of razzias, severe penalties and strong verbal commitments to clean government in response to protests by domestic victims, affected enterprises and international funding organizations. Depending on the type of regime, such pendular movements may sometimes assume the form of palace rebellions, coups d'état or democratic elections in which the old rascals are thrown out.

The double standards as far as 'private tariffs' are concerned may be an important reason why campaigns against corruption and traditional legal reform approaches so often fail in low-income countries. As an alternative, Kaufmann argues that much more attention should be given to monitoring tools, external accountability and mechanisms of transparency.¹⁸

Regular *taxes* are not so common in the shady world of corruption as they are in the well-lit world of legitimate government. Taxation has a number of properties which are not easily adaptable to illicit extraction: formal rules, regular intervals, predictability, and official forms of execution. Nevertheless there are certain forms of corrupt levies that exhibit a certain similarity with taxes. One prominent type is the secret tax exacted by various radical and ruthless political movements in the quest of ethnic autonomy. The merchants belonging to the minority in question will often be pressed to make regular payments to such causes, at the risk of serious sanctions.

The threat of sanctions is also paramount in the wide-ranging private 'protection industry' prevalent in many countries. This industry is, in many ways, reminiscent of primitive government, where the sword was always double-edged: it could be used for protection against extraneous aggressors and oppressors but also be turned against recalcitrant subjects failing to honour their imposed or agreed obligations. Through many battles, the modern state acquired what Max Weber

called the monopoly on legitimate violence. Yet other forms of violence, dubbed as illegitimate, did of course persist, and in some societies there have emerged Mafia networks that locally challenge the state's monopoly on armed coercion. Where this is the case, we can observe the incidence of 'double taxation' as asset-owners feel compelled to pay for two different forms of protection. With an expanding legal protection industry entering the market as a third, intermediate force, there may even be an element of 'triple taxation' in some cases.

The relationship between illegal *trade* and corruption is not entirely easy to disentangle. On the one hand, the black market is negatively defined by the fiscal system since it is that part of the economy that is situated beyond the reach of the tax collectors. It is also largely beyond the reach of the official statisticians, which places it outside official GDP data. While some palms are certainly greased to facilitate the unimpeded pursuit of lucrative activities outside the law, there is also a wide domain of illegal undertakings carried out without the knowledge, connivance and interference of any authorities, and accordingly without bribery. In this sense, there is only limited corruption and much less total extraction in the black market than in the legal sphere. Yet if corruption is understood in its broader sense to include a variety of illegal undertakings such as smuggling, trafficking and money laundering, there is on the other hand a great deal of private revenue linked to different types of illicit commerce. Corrupt politicians and public officials can also be said to engage in a form of trade as they sell specific favours.

To summarize, three conclusions seem warranted.

- For each one of the four typical forms of government revenue, there is an analogous type of illicit levy employed in the sphere of corruption. Yet when we look at the proportions between the different types, we find diverging patterns. Most bribes seem comparable to a form of government revenue that is characteristic particularly of early, ancient and semi-modern societies: in the first place tariffs, and in the second place tributes. Taxation, which has evolved as the predominant source of fiscal receipts in the modern state, is much less frequent in the context of corruption.
- The kinship between bribery and extraction by pre-modern rulers adds evidence to the suggestion that observations of Mafia behaviour and criminal clans may teach us a few lessons about the origins and genetic evolution of the state. Just as 'robber capitalism' precedes the more civilized versions of the market economy, government seems to pass through many brutal and unkempt forms before it attains some measure of legitimacy and acceptance. In this evolutionary process, there is, for a long time, no sharp borderline between fiscal and illicit modes of extraction.

- An important reason for the blurred boundary is to be found in the evolving logistics of government extraction. It is only in recent times and highly monetarized economies that governments have managed to direct their fiscal flows straight to the central treasury. Previously, payments were made through several layers of intermediary. The feudal system was based on a successive transfer of resources from the subjects to the crown through vassals and sub-vassals. Later on, employed bailiffs or *intendants* performed the same service with less autonomy. For centuries, however, there were also considerable streams of fiscal levies that were earmarked to, and collected immediately by, local recipients with particular public functions, such as in the elaborate system of apportionment (*indelningsverk*) set up by Charles XI of Sweden. This mediated form of taxation generated many frictions through quarrels over the appropriate quantity and quality of in-kind payments.

Towards a composite measure of the extraction burden

The variations of the fiscal load over time and across national boundaries are well mapped. As for the historical evolution, there is a rich literature to confirm the famous thesis by Adolph Wagner that the proportion of public revenues and expenditures to GDP tends to grow over time with economic development. During the 20th century, the government turnover in industrial states rose from less than 10% of the GDP to between 40 and 50%. This trend was particularly brisk during the great economic expansion in the three or four decades following the Second World War.

Cross-national comparisons confirm Wagner's thesis by highlighting the spread in public revenues between low-income and high-income countries. With the classification scheme employed by the World Bank, fiscal quotas range from less than 15% of GDP in predominantly agricultural economies to around 30% of GDP in advanced industrial and service-oriented nations. Higher figures are also in circulation, based on more inclusive measures of government revenues.

Unfortunately, the hard data on fiscal receipts cannot be compared to any corresponding information about bribery. The rapidly expanding research on corruption relies chiefly on comparative perception surveys. But from such studies very interesting results have been reported in recent years, permitting significant advances in our understanding both of the scope of corruption in different countries and of the mechanisms sustaining it. Several inquiries shed new light on the relationship between perceived corruption and variables gauging public sector salaries, the rule of law, the quality of government and other measures related to the size of the public sector.

Razafindrakoto and Roubaud have reported a strong negative correlation between the level of corruption and state employee wages. Drawing on household and labour force surveys as well as indicators of personal experience and perceptions of corruption, they find declining corruption in a period of significant pay increases to civil servants.¹⁹ Conclusions from a policy experiment carried out in Buenos Aires add a further dimension. Here, higher wages are deemed to reduce the level of corruption only in combination with more intense audits.²⁰ Rose has measured perceptions on corruption among public officials in Central and Eastern Europe. According to his New Europe Barometer, respondents in countries with a lower per capita GDP such as Lithuania, Latvia and Romania are much more prone to reply that most or almost all public officials are corrupt than interviewees in countries with a higher GDP per capita, such as Slovenia and Hungary.²¹

An important data set on the quality of governance has been constructed by World Bank researchers in 1997–98 and later updated to cover 170 countries for 2000–2001. The composite indicators are based on over 190 measures of perceptions of governance compiled by 17 organizations worldwide. The six dimensions are control of corruption, rule of law, government effectiveness, voice and accountability, regulatory quality and political stability. Figure 1 illustrates the correlation between GDP per capita at PPP in 1995 and indices for control of corruption from the 2000–2001 study, confirming the conventional assumption that this scourge is much more salient in low-income countries.²²

Two recent comprehensive efforts to assess the distribution of bribery are the 2002 Bribe Payers' Index and the 2002 Corruption Perceptions Index.²³ The former is based on comprehensive studies on bribe-paying in international trade, focusing on business practice rules and other factors influencing corruption. The latter is a composite index based on a large number of studies (15 data sources from nine different institutions), aggregating the perceptions of well-informed people on the overall prevalence of corruption in different countries.

While providing a wealth of information about the global map of bribery, these two indices do not offer any clues about the magnitude of illicit payments. Yet a third major study carried out by the World Bank brings us a bit closer to an answer to that question. In the World Business Environment Survey (WBES), more than 10 000 firms in 80 countries were asked to assess the impact of corruption on their own business activities. In Figure 2, the country average ratings of general corruption constraints are related to the total revenues of general government.²⁴

The WBES firms were also asked to indicate the total percentage of their revenues paid to officials as unofficial payments to public officials. Eighty-three percent of firms in the OECD countries and 58% of those in Latin America reported making no such payments, whereas only 0.9% of firms in Central and

Comparing governance and per capita income worldwide

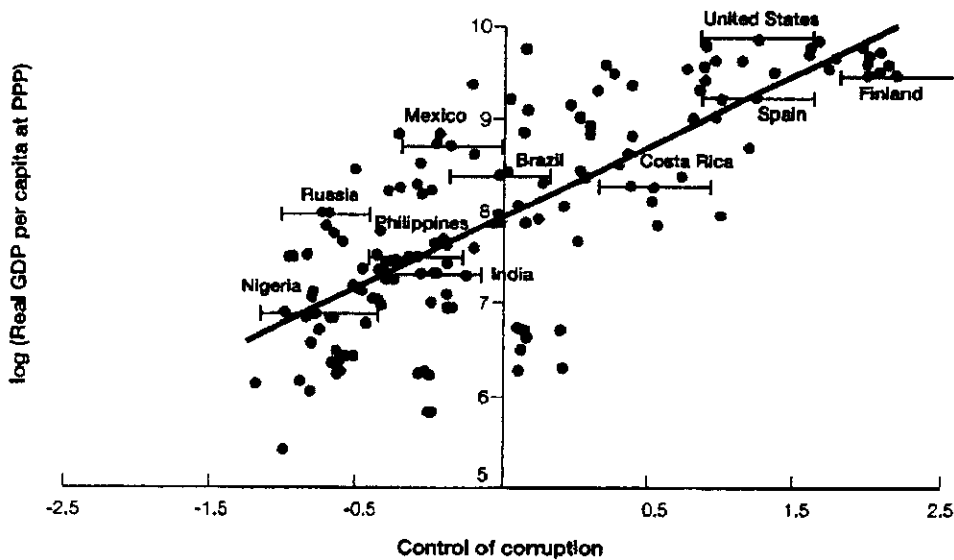


Figure 1. Comparing governance and per capita income worldwide. Source: *2003 Global Corruption Report* (Berlin: Transparency International), p. 303. The horizontal bars for selected countries indicate the statistically likely range of values for each country. The ratings are based on subjective assessments from a variety of sources.

Eastern Europe and 3.8% of firms in CIS countries reported zero payments. Overall, the 'bribe tax' appeared to be regressive: small firms worldwide reported paying an average 3.8% of their revenues to public officials, medium-sized firms 2.7% cent and large forms 1.7%.

The WBES findings should be interpreted with caution, since questions about grease in business are not likely to elicit entirely sincere answers, but it seems safe to assume that under-reporting of corrupt practices is far more probable than over-reporting. When firms in Central and Eastern Europe indicate paying 5.5% and firms in South Asia claim to be paying 5.0% of their revenues in unofficial payments to public officials, we might therefore suspect that the actual flow is somewhat bigger. The figure of 0.6% for OECD countries could likewise be an understatement of the real scope of corruption.²⁴ But assuming, *faute de mieux*, that these are adequate measures of the phenomenon, what would such elements add to the construction of an 'extraction quota'?

The 'fiscal quota', or percentage of GDP paid to the government, can of course be gauged in many different ways. There are several levels of government, several

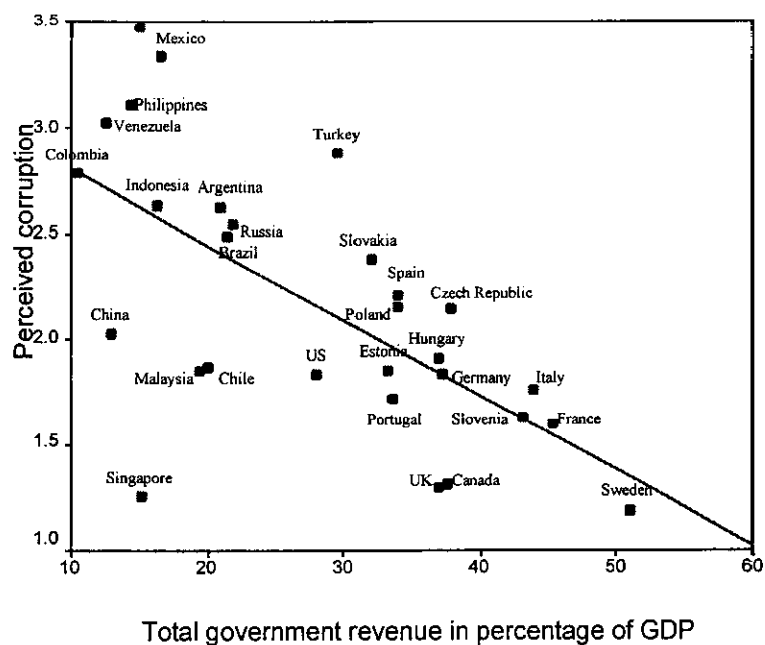


Figure 2. Country average ratings of general corruption constraints in relation to general government revenues as a percentage of GDP (2000). Swedish Institute for Growth Policy Studies (ITPS) calculus based on WBES and World Bank data.

types of levy, and several grey zones in between the public and the private sectors, the payments to which may be accounted for one way or the other. But assuming that World Bank statistics on government finance for the year 2000 are consistent, the picture is the following: in high-income countries, the average fiscal quota (defined as 'government revenues, excluding grants') is 28.4%; in upper-middle income countries, 22.3%; in middle income countries, 17.7%; in lower-middle income countries, 16.6%; and in low-income countries, 15.0%.

In the OECD countries, adding the 0.6% assumed 'corruption quota' to the fiscal quota obviously would not make much of a difference. Yet in poor and disorderly countries, the share of illicit payments in total transaction costs is significantly higher. For South Asia, where WBES data suggest a 'corruption quota' of 5.0%, World Bank statistics indicate a fiscal quota of 13.7%. Adding together these two components, we would arrive at an 'extraction quota' of 18.7%. This is still a far cry from the OECD share, but when unofficial payments to officials are taken in account, we will nevertheless find a markedly narrowing gap between different types of country.

On the basis of an interesting attempt to study the relationship between corruption and the fiscal system, Tanzi & Davoodi (2001) argue that bribes

affect the structure of taxation. According to their evidence the presence of higher corruption may in part explain the predominant share of indirect taxes in total tax revenues. Yet, as they also observe, there is room for doubt about the direction of causation.²⁵ The reasoning in this paper would make it more plausible to trace both the composition of government revenue and the prevalence of corruption to a common set of preconditions linked primarily to the level of economic development and the political framework. Where fiscal instruments are weak and the government's capacity to make payments for services accordingly feeble, a disorderly society will invent supplementary forms of extraction.

Conclusions: the many faces of extraction

'I pay my tax bills more readily than any others – for whether the money is well or ill spent I get civilised society for it.'²⁶ The cheerful idealism expressed by Justice Oliver Wendell Holmes Jr in a letter to Harold Laski in 1930 may not have many supporters among today's taxpayers, but a closer look at fiscal psychology will at least reveal some striking elements of ambivalence in our attitudes to taxation. While most of us are none too eager to pay our own taxes, we can readily see the benefits of others paying theirs. Living among taxpayers is more pleasant than being one.

The literature on economic growth pays considerable attention to taxation levels, but there is often a tendency to overlook both the 'shadow taxes' linked to corruption, and the extra costs that the firms and households of low-tax societies have to bear to finance goods and services that are predominantly public in high-tax societies, whether it be health care, education, security, or physical infrastructure. To get a realistic picture of the transaction outlays in different economies, all such types of expenditure would have to be taken into account.

Adding taxes and corruption receipts leads us a good way towards a composite measure of total extraction costs. But a third element should also be mentioned. Besides the vertical flow of resources from the taxpayers to the public treasuries there is also, in all societies, a horizontal flow of extraction to non-state recipients that is supported by privilege, regulation or legislation. Many governments depend for their survival on coalitions of stakeholders engaged in their own protected forms of extraction. In early, feudal and pre-modern societies, taxation is normally decentralized and mediated, but even in advanced industrial states there are many fiefs attributed to particular influential strata. In such areas, we often encounter private versions of the tariff system analysed above, or even private versions of taxation. To sharpen our understanding of such forms of extra-fiscal obligations and arrive at a satisfactory composite measure of the total extraction burden, we would need a great deal of further research in the borderland between politics, law and economics.

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