

Political Science

**The Political Economy of Public Administration  
Reforms in Southeast Asia:**

**A Comparative Analysis of the Tax Administration in  
Indonesia and the Philippines**

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## Abstract

Within the last decade, scholars and practitioners have increasingly discussed domestic resource mobilization as a development financing tool. Revenues from domestic sources are regarded as more stable than resources derived from world capital markets. Moreover, taxes are ascribed a positive impact on state building and good governance. In most developing and transition countries, so far, the tax ratio has been lower than the internationally advocated twenty percent of their gross domestic product.

Within this context, research on taxation in developing countries has grown, and efforts to improve tax systems have proliferated globally. Strong interest and rhetoric on enhancing domestic resource mobilization however does not necessarily translate into more effective and efficient, equitable and impartial tax systems as previous experience has shown. The reasons accounting for low tax efforts and for the relative success and failure of tax reforms in many countries have remained under-researched. This has been particularly true for countries in Asia, Central Asia and the Middle East.

This study contributes to this research gap by a comparative political economy analysis of the Indonesian and Philippine cases. The study focuses on the tax administration reforms of the years 2002 to 2010. It applies an actor-centred historical institutionalism approach and uses the neopatrimonialism concept as its main analytical lens. Due to the scarcity of related academic research and published material, the study relies to a large degree on the analysis of primary sources. The study's insights draw on 90 formal expert interviews and four focus group discussions with respondents from inside and outside the tax authorities conducted in 2009. Field mission information collected in 2012 complements these perspectives. A detailed review and analysis of annual national budgets, budget speeches, and state of the nation addresses, relevant legislation, journal articles, and newspaper articles substantiate the study further.

Based on these data, the study describes how the tax administrations are structured and reveals how taxes are administered by law and in practise. It analyses what accounts for the shortcomings and weaknesses in taxation. Further it describes what kind of efforts the governments are pursuing to increase their tax take. It analyses the processes of these modernization and reform efforts and examines the factors why Indonesia in comparison with the Philippines has been widely perceived as the more successful reformer during the period under observation.

The study finds that many of the shortcomings and weaknesses the tax administrations in both countries show are institutionalised. They have existed for decades and often been deliberately created and sustained. Path dependence makes it difficult for reforms to be implemented. Yet, human agents choose directions, therefore can overcome institutional constraints. The study suggests that two agency-related factors are highly decisive in explaining the different outcomes of reforms. These are the degree of power concentration found in a country in combination with the perceived strength of change management applied in the reform process. There is evidence, that the successful implementation of reforms is the more unlikely the more concentrated power, in other words the higher the degree of economic elite capture of politics and bureaucracy. Yet, strong change management holds the potential to overcome resistance against reforms.

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## Abbreviations and Acronyms

ADB	Asian Development Bank
AIPEG	Australia Indonesia Partnership for Economic Governance
APBN	State Budget <i>Anggaran Pendapatan dan Belanja Negara</i>
ASEAN	Association of Southeast Asian Nations
Aspri	Personal Assistant <i>Asisten Pribadi</i>
ATAF	African Tax Administration Forum
AusAID	Australian Agency for International Development
Bapepam & LK	Capital Market and Financial Institution Supervisory Agency
Bappenas	State Ministry of National Development Planning <i>Badan Perencanaan Pembangunan Nasional</i>
BIR	Bureau of Internal Revenue
BIREA	BIR Employees' Organisation
BKN	National Civil Service Agency <i>Badan Kepegawaian Negara</i>
BMZ	Federal Ministry for Economic Development and Cooperation <i>Bundesministerium für wirtschaftliche Zusammenarbeit und Entwicklung</i>
BOC	Bureau of Customs
BOI	Board of Investments
BPK	Supreme Audit Board <i>Badan Pemeriksa Keuangan</i>
BPKP	State Development Audit Agency <i>Badan Pengawasan Keuangan dan Pembangunan</i>
BPPK	Ministry of Finance's Education and Training Centre <i>Badan Pendidikan dan Pelatihan Keuangan</i>
BPS	Statistics Indonesia <i>Badan Pusat Statistik</i>
BRIIC	Emerging Economies Brazil, Russia, India, Indonesia, China
CEPAL	Economic Commission for Latin America and the Caribbean <i>Comisión Económica para América Latina y el Caribe</i>
CETRO	Center for Electoral Reform
CIAT	Inter-American Center of Tax Administrations <i>Centro Interamericano de Administraciones Tributarias</i>
CIDA	Canadian International Development Agency
CIR	Commissioner of Internal Revenue
COA	Commission on Audit
CPI	Corruption Perceptions Index
CSC	Civil Service Commission
CTA	Court of Tax Appeals
DBCC	Development Budget Coordination Committee

DBM	Department of Budget and Management
DFID	Department for International Development
DGCE	Directorate General of Customs and Excise <i>DBC, Direktorat Bea dan Cukai</i>
DGT	Directorate General of Taxes <i>DJP, Direktorat Jenderal Pajak</i>
DOF	Department of Finance
DOJ	Department of Justice
DPD	Regional Representatives Council <i>Dewan Perwakilan Daerah</i>
DPI	Database of Political Institutions
DP3	Annual Staff Appraisal <i>Daftar Penilaian Pelaksanaan Pekerjaan</i>
DPR	People's Representative Council, National Parliament <i>Dewan Perwakilan Rakyat</i>
DPSP	Development Policy Support Program
DPWH	Department of Public Works and Highways
EC	European Commission
Ecozones	Special Economic Zones
EIU	Economist Intelligence Unit
EO	Executive Order
FGD	Focus Group Discussion
Formasi	National Staff Establishment
FTA	OECD Forum on Tax Administration
G7	Group of Seven
G20	Group of Twenty
GAC	Governance Advisory Council
GBHN	Broad Outlines of State Policy <i>Garis-garis Besar Haluan Negara</i>
GDP	Gross Domestic Product
GFMRAP	Government Financial Management and Revenue Administration Project
GOCC	Government Owned and/or Controlled Corporation
Golkar	Party of the Functional Groups <i>Partai Golongan Karya</i>
GOI	Government of Indonesia
GOP	Government of the Philippines
HB	House Bill
HDI	Human Development Index
HDN	Human Development Network
HIID	Harvard Institute for International Development
HR	Human Resources
ICT	Information and Communication Technology
ICW	Indonesia Corruption Watch
IDAP	Integrity Development Action Plan
IFI	International Financial Institution
IG	Inspectorate General <i>Inspektorat Jenderal</i>

ILO	International Labour Organization
IMF	International Monetary Fund
IRR	Implementing Rules and Regulations
IT	Information Technology
ITC	International Tax Compact
ITD	International Tax Dialogue
JICA	Japan International Cooperation Agency
KADIN	Indonesian Chamber of Commerce and Industry <i>Kamar Dagang dan Industri Indonesia</i>
Karikpa	Tax Audit and Investigation Office <i>Kantor Pemeriksaan dan Penyidikan Pajak</i>
KIP	Tax Inspection Office <i>Kantor Inspeksi Pajak</i>
KITSDA	Directorate of Internal Compliance and Transformation of Apparatus Resources <i>Direktorat Kepatuhan Internal dan Transformasi Sumber Daya Aparatur</i>
KKN	Corruption, Collusion and Nepotism <i>Korupsi, Kolusi dan Nepotisme</i>
Korpri	Corps of Civil Servants of the Republic of Indonesia <i>Korps Pegawai Negeri Indonesia</i>
KP2KP	Taxation and Consultation Office <i>Kantor Pelayanan Penyuluhan dan Konsultasi Perpajakan</i>
KPK	Corruption Eradication Commission <i>Komisi Pemberantasan Korupsi</i>
KPP BB	Land and Building Tax Office <i>Kantor Pelayanan Pajak Bumi dan Bangunan</i>
KPP	District Tax Service Office <i>Kantor Pelayanan Pajak</i>
KPP	Taxation Supervisory Council <i>Komite Pengawas Perpajakan</i>
KTP	Identity Card <i>Kartu Identitas Penduduk</i>
LAN	National Institute of Public Administration <i>Lembaga Administrasi Negara</i>
LEADC	Legislative-Executive-Advisory Council
LHKPN	Wealth Report <i>Laporan Harta Kekayaan Penyelenggara Negara</i>
LIC	Low Income Countries
LOI	Letter of Intent
LTO	Large Taxpayer Office
LTS	Large Taxpayers Service
Markus	Case Broker <i>Makelar Kasus</i>
MCA-PTP	Millennium Challenge Account-Philippines Threshold Program
MCC	US Millennium Challenge Corporation

MenPAN &RB	Ministry for the State Apparatus and Bureaucracy Reform <i>Kementerian Pendayagunaan Aparatur Negara dan Reformasi Birokrasi</i>
MoF	Ministry of Finance <i>Depkeu, Departemen/Kementerian Keuangan</i>
MPR	People's Consultative Assembly <i>Majelis Permusyawaratan Rakyat</i>
MTI	Indonesian Society for Transparency <i>Masyarakat Transparansi Indonesia</i>
MTO	Medium Taxpayer Office
NAP	No Audit Program
NEDA	National Economic and Development Authority
NIRC	National Internal Revenue Code
NPCS	New Payment Controls System
NPM	New Public Management
NPPKP	Taxable Entrepreneur Confirmation Number <i>Nomor Pengukuhan Pengusaha Kena Pajak</i>
NPSTAR	National Program Support for Tax Administration Reform
NPWP	Taxpayer Registration Number <i>Nomor Wajib Pajak Pokok</i>
ODA	Official Development Assistance
OECD	Organisation for Economic Co-operation and Development
OFW	Overseas Foreign Worker
OSVIA	Training schools for native officials in colonial Indonesia <i>Opleidingsscholen Voor Inlandsche Ambtenaren</i>
PAGC	Presidential Anti-Graft Commission
Pagcor	Philippine Amusement and Gaming Corporation
PAN	National Mandate Party <i>Partai Amanat Nasional</i>
PARE	Presidential Advisor on Revenue Enhancement
PCIJ	Philippine Center for Investigative Journalism
PDAF	Priority Development Assistance Fund
PDI-P	Indonesian Democracy Party of Struggle <i>Partai Demokrat Indonesia – Perjuangan</i>
PEZA	Philippine Economic Zone Authority
PINTAR	Project for Indonesian Tax Administration Reform
PFM MDTF	Multi-Donor Trust Fund to Support Public Financial Management and Revenue Administration Reforms
Plantilla	Civil service establishment positions
PMIS	Project Management and Implementation Service
P	Philippine Peso
PP	Government Regulation <i>Peraturan Pemerintah</i>
PPATK	Financial Transaction Reports and Analysis Centre <i>Pusat Pelaporan dan Analisis Transaksi Keuangan</i>
PKB	National Awakening Party <i>Partai Kebangkitan Bangsa</i>

PKS	Prosperous Justice Party <i>Partai Keadilan Sejahtera</i>
PT	Incorporated, Limited <i>Perseroan Terbatas</i>
PTTAF	Policy, Training and Technical Assistance Facility
Pusdiklat Pajak	Tax Education and Training Unit <i>Pusat Pendidikan dan Pelatihan Pajak</i>
RA-FIT	Revenue Administration's Fiscal Information Tool
RAPBN	State Budget Draft <i>Rancangan Anggaran Pendapatan dan Belanja Negara</i>
RARP	Revenue Administration Reform Project
RATE	Run After Tax Evaders
RATS	Run After The Smugglers
RDO	Revenue District Office
RIPS	Revenue Integrity Protection Service
RMC	Revenue Memorandum Circular
RMO	Revenue Memorandum Order
RMR	Revenue Memorandum Ruling
Rp	Indonesian Rupiah
RR	Revenue Region
RR	Revenue Regulation
SALN	Statement of Assets, Liabilities, and Net Worth
SARA	Semi-Autonomous Revenue Agency
SB	Senate Bill
SGATAR	Study Group on Asian Tax Administration and Research
SIDA	Swedish International Development Agency
SIDJP	DGT Information System <i>Sistem Informasi Direktorat Jenderal Pajak</i>
SIP	Tax Information System <i>Sistem Informasi Perpajakan</i>
SISMOP	System for the Management of Taxpayers' Information <i>Sistem Manajemen Informasi Objek Pajak</i>
SOP	Standard Operating Procedure
STAN	Indonesian State College of Accountancy <i>Sekolah Tinggi Akuntansi Negara</i>
Stafsus	Special Staff <i>Staf Khusus</i>
STO	Small Taxpayer Office
Susenas	Indonesian National Socioeconomic Survey <i>Survei Sosial Ekonomi Indonesia</i>
SWS	Social Weather Stations
TAMF III	Technical Advisory Management Facility for Economic Governance
TAN	Taxpayer Account Number
THR	Holiday Allowance <i>Tunjangan Hari Raya</i>
TI	Transparency International
TIN	Taxpayer Identification Number

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TPA	Final Selection Team <i>Tim Penilai Akhir</i>
TRAG	Tax Reform Administration Group
UN	United Nations
UU	Law <i>Undang-Undang</i>
USAID	United States Agency for International Development
VAT	Value-Added Tax
VOC	Dutch East India Company <i>Vereenigde Oost-Indische Compagnie</i>
WGI	World Governance Indicators



# 1 Introduction

*Taxation is the art of the possible. A tax system that is not administrable is not worth much. The theoretically most perfect tax system in the world may become a bad system if the intention expressed in the law is distorted by the practice (Vito Tanzi 1992)*

## 1.1 Background: Why Study Tax Administration Reforms?

The provision of public goods and services constitutes a core function of the state. The degree to which a state is willing and able to fulfil this function, that is to meet its citizens' needs and expectations, is an important factor influencing in how far a government's rule is perceived legitimate. With legitimacy being linked to public welfare and public expenditures constrained by available resources, states depend on raising revenues. Developed countries draw most of their revenues from domestic sources, derived from taxation, duties and levies, social contributions, and capital market instruments. Resource-rich countries derive a large share of their income from primary commodity exports, such as hydrocarbons and minerals. Transition countries and even more developing countries tend to rely on international sources, that is official development aid, foreign loans, and grants. Developing countries' tax ratios, that is the percentage of total tax revenues to GDP, tend to be low.

In 2009, the global average tax ratio of low-income countries was 14%. The average tax ratio of lower-middle income countries reached 18% (Gupta 2011: 9).<sup>1</sup> There is a relation between GDP and tax ratio, yet low revenue performance is not caused by low socio-economic development alone. Various studies indicate that in many developing countries at least 50% of the taxes that could be collected remain uncollected as a consequence of poorly functioning tax authorities, widespread corruption, tax avoidance, and tax evasion (Das-Gupta/Mookherjee 1998: 3; Fjeldstad/Tunggodden 2003: 1459). Potential revenues are further lost due to a small tax base, mirroring the prevalence of large informal sectors and professionals outside the tax net, ill-conceived tax policies, tax exemptions, and tax incentives (Alm et al. 2004). It is impossible to quantify the absolute amount of revenues lost. Yet, there is little doubt that the sums are very large.

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<sup>1</sup> Low-income countries have a gross national per capita income of US\$ 1.025 or less; lower middle income countries of US\$ 1.026 to US\$ 4.035. Tax performance varies between regions; while Sub-Saharan Africa's results are mixed and low tax performance prevails in Latin America, South and Southeast Asia are notorious low performers. Trend analysis indicated "that tax revenue performance has strengthened in sub-Saharan Africa since the mid-1990s but weakened in developing Asia" (IMF 2011: 15).

These conditions give reason for concern and call for action. Concern, as international benchmarks suggest that a minimum tax ratio of 20% is needed to provide for productive expenditures. Lower tax ratios would impede development; tax ratios below 10% not even suffice to sustain basic living standards (IMF 2005: 47).<sup>2</sup> A stronger tax effort thus is needed to sustainably resolve fiscal challenges. Action, as arguably raising revenue through domestic taxation, rather than through foreign aid and commodity exports, has decisive advantages. Based on the rentier state theory (Beblawi/Luciani 1987; Boeckh/Pawelka 1997) and the related idea of the state-citizens fiscal contract (Levi 1988), there is evidence of the validity of a taxation, state-building, and governance triad (Bräutigam et al. 2008). With taxation, so the main argument, state accountability and its quality of governance increases, as taxpaying citizens hold the necessary leverage to make political demands (Moore 2004, 2007; Prichard 2010a; Altunbas/Thornton 2011). Better democratic representation, state accountability, and good governance in turn are perceived as keys for poverty reduction and sustainable development. In other words, tax reforms can be the catalyst for broader improvements in state administrative capacity, government performance, and related broad-based socio-economic development (Prichard/Leonard 2010).

The benefits of domestic taxation and the considerable scope for improvement are discussed not only among academics, but also increasingly emphasised in international fora and processes: The 2002 United Nations Monterrey Consensus on Financing for Development identified mobilising domestic resources as one of the six leading actions for development (UN 2002: 6-9). The 2008 Doha Declaration pledged to “step up efforts to enhance tax revenues through modernized tax systems, more efficient tax collection, broadening the tax base, and effectively combating tax evasion” (UN 2008: 8-9).<sup>3</sup> In 2010, the Group of Twenty (G20) identified domestic resource mobilization as a “key pillar” where action and reform is “most critical to ensure inclusive and sustainable economic growth and resilience in developing countries and LICs”.

Prime responsibility to improve tax systems lies with developing countries in partnership with the donor community. To that effect, the G20, in its multi-year action plan on development, demanded three main actions: support the development of more effective tax systems, support work to prevent erosion of domestic tax revenues, and enhance the effectiveness and reach of knowledge sharing (G20 2010). In response, the leading international organisations, the IMF, the OECD, the United Nations, and the World Bank, prepared a common report detailing concrete deliverables that they could provide (IMF 2011). — Following a long-term neglect, “Taxation is about to become a

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<sup>2</sup> Figures may not apply to states with large non-tax revenues, which do not have strong incentives to engage in revenue collection. For a critical assessment of the tax ratio approach see von Haldenwang/Ivanya (2010).

<sup>3</sup> Directly related are the agenda for aid effectiveness and capacity building (High Level Forum 2005, 2008)

central – if not *the* central – topic in the development debate – also in developing countries” (Fjeldstad 2009: 4; cf. Keen 2012: 3).<sup>4</sup>

International organisations, state federations, and individual states have stepped up engagement in tax cooperation and tax reform. For instance: The International Tax Dialogue, a collaborative arrangement of the IMF, the OECD, and the World Bank Group “to encourage and facilitate discussion of tax matters among national tax officials, international organisations, and a range of other key stakeholders” has been fostered (OECD 2010). The European Union issued several communiqués on tax and development, highlighting the importance of efficient and equitable tax systems for “growth, poverty reduction, good governance and state-building” (EC 2009, 2010). And Germany launched the ITC, International Tax Compact, an informal platform for dialogue and joint action to “promote effective, fair and efficient tax systems and combat tax evasion and inappropriate tax practices on a global scale” (ITC 2010).

Also, the OECD created an Informal Task Force on Tax and Development, while the IMF (2011) launched a Topical Trust Fund on Tax Policy and Administration. Recent surveys on international cooperation in capacity building in the area of taxation show that tax reform programmes proliferated globally (Michielse/Thuronyi 2010). A mapping exercise of donor activities in the field of taxation indicates that more than 100 countries worldwide were pursuing tax-related reforms assisted by international donors in 2010 (ITC 2010: VI).

Within the regions, development banks, notably the Inter-American Development Bank and the African Development Bank, and tax organisations, such as CIAT, the Inter-American Centre of Tax Administrations, and ATAF, the African Tax Administration Forum, have intensified their work on tax reforms. Exceptions are the Asian Development Bank and SGATAR, the Study Group on Asian Tax Administration and Research, which at least until late 2012 have not yet carried out “any systematic measurement of capacity in tax administration systems in Asia” (IMF et al. 2011: 39).<sup>5</sup>

Strong interest and rhetoric on enhancing domestic resource mobilization however does not necessarily translate into more effective and efficient, equitable, and impartial tax systems. Previous reforms in developing countries, transition, and emerging market economies show that results are mixed. These include reform activities such as the regular tax policy design exercises undertaken worldwide since the 1970s or the almost ubiquitous establishment of semi-autonomous revenue authorities, moving administration and enforcement of tax collection out of the Ministry of Finance, into a separate agency in Anglophone Africa and many Latin American countries since the

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<sup>4</sup> The magnitude of this change can be perceived when recollecting Curtis’s (1989: 1424) assessment twenty years ago: “Taxation is probably the most significant political phenomenon that political scientists have left relatively unexplored”.

<sup>5</sup> For many years, the ADB has not paid much attention to taxation; the situation has been changing only very slowly. The leading international organisations had explicitly recommended G20 Asian countries to “engage the ADB to facilitate the collection of similar comparative information to that collected by the FTA” (IMF et al. 2011: 42). The ADB has responded; it has sent the surveys to Asian member countries’ tax authorities, yet progress in data collection has been slow.

late 1980s.<sup>6</sup> While some countries made substantial advances in modernizing and reforming their tax systems, other countries achieved very little (Taliencio Jr. 2004; Kidd/Crandall 2006; Fjeldstad/Moore 2009). Many countries could not fulfil expectations. Reforms were delayed, altered and/or blocked altogether (IMF 2011: 17). Both from an academic and a practical standpoint, knowledge about the reasons accounting for low tax efforts and for the relative success and failure of tax reforms is of high relevance.

## 1.2 Research Questions and Empirical Approach

Motivated by the empirical puzzle of why some countries fare comparatively better reforming their tax system than other countries, the main objective of this political science study, borrowing ideas from economics, public administration, law, and economic history, is to shed light into two overarching and interrelated questions:

*First, it seeks a better understanding of shortcomings and weaknesses in taxation in developing countries.*

*Second, it tries to explain why reform experiences differ.*

Founded in the positivist epistemological tradition, a qualitative research approach, complemented by quantitative elements, is adopted.

The study analyses the political economies of recent tax reforms in two Southeast Asian countries: Indonesia, widely believed as being the more successful, and the Philippines. Framed as a structured and focused comparative analysis, the study explores the argument of taxation as a fundamentally political issue (Kaldor: 1963: 418).

The analysis of tax reforms is well suited to reveal the relations and interactions between the government, bureaucracy, the economic elite, and vested interests in the state.<sup>7</sup> The understanding of the underlying game in turn helps us to understand the dynamics of taxation and tax reforms.

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<sup>6</sup> By 2010, there were close to 40 semi-autonomous revenue authorities around the world, clustered largely in Africa and Latin America (Crandall 2010: 7). Within Southeast Asia the only semi-autonomous revenue authorities are the Inland Revenue Authority of Singapore (est. 1992), the Inland Revenue Board of Malaysia (*Lembaga Hasil Dalam Negeri Malaysia*, est. 1994), and the General Department of Taxation in Viet Nam (*Thuế Việt Nam*). Araki (2012: 3) also classified the Philippines' Bureau of Internal Revenue as a semi-autonomous body. While the author sees that the BIR traditionally has been more under the control of the president than the finance minister, she did not find enough indications that the BIR is sufficiently autonomous to agree with Araki.

<sup>7</sup> Schumpeter (1991 [1918]: 101) made a comparable point, when he stated that, "The public finances are one of the best starting points for an investigation of society, especially though not exclusively of its political life".

From an actor-centred historical institutional perspective, the relationship of formal and informal institutions is analysed. The interaction of actors within these institutions is further scrutinised. The concept of neopatrimonialism functions as the study's main analytical lens and one variable among a set of different independent variables. Tax reform outcomes are considered the dependent variable. The study is restricted to the tax administration and taxes collected at the national level.

Due to the scarcity of academic research and published material on taxation in Southeast Asia, the study is informed by theory and secondary sources, but relies to a large degree on the analysis of primary sources. During field research in 2009 in Indonesia and the Philippines, the author conducted 90 formal expert interviews and organised four focus group discussions with respondents from inside and outside the tax authorities, and collected a wide variety of government reports, documents, and records related to the civil service, tax administration, and tax administration reforms. In addition, the author retrieved and analysed a large amount of local print and digitised newspaper and magazine articles.<sup>8</sup> In 2012, another set of interviews with key stakeholders in both countries was conducted. These allowed the insights gained before to be put to a final test for completeness, reliability, and objectivity.

### 1.3 Contributions and Limitations

The study makes several important contributions. Foremost, it contributes substantially to increased empirical knowledge on the dynamics of taxation in Southeast Asia. As will be pointed out for the two case studies, Indonesia and the Philippines, in more detail later, “objective, codified and accessible knowledge on the capability of tax administration systems in Asia, Central Asia and the Middle East is extremely limited” (IMF et al. 2011: 41).<sup>9</sup> Little information on present day tax policies and even less information on tax administration exists. It is hardly known how the tax authorities are structured, how taxes are administered, not only *de jure* but also *de facto*, what kind of efforts the governments are pursuing to improve their tax take, and why things are likely to be the way they are. There is broad-based international consensus that it is high time to change this situation. This study helps to fill this significant research gap.

Further, by exposing concrete practices of alleged elite interference in tax administration, it provides fresh insights into relations between the government, bureaucracy, economic elites, and vested interests in the state. Presuming the ‘virtuous

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<sup>8</sup> In quotations only the abbreviated names of the newspapers and magazines and the date of publication are given. The journalists' names are intentionally omitted.

<sup>9</sup> The situation for OECD-countries, Sub-Saharan Africa and Latin America differs. The most comprehensive, albeit survey based, international comparison of tax authorities, in March 2011 covering 49 countries, so far has been published by the Forum on Tax Administration (FTA) (OECD 2011). The ITD (2010) has published a pilot study on 15 revenue administrations in Sub-Saharan Africa, while CIAT and CEPAL have produced publications on tax administrations in the majority of Latin American countries (Sabaini et al. 2012; CIAT 2012). Only in 2013, the ITC (2013) has prepared a study on six Southeast Asian countries.

circle' of taxation, improved governance, and development, the insights gained are valuable for both academia and practice.

Methodologically, the study proves that neopatrimonialism, a concept predominantly used to explain state-weakness and stalled development in Sub-Saharan Africa, can be applied successfully to Southeast Asia. Yet, it argues that the limitation of power concentration to big man rule falls short in explanatory power. The degree of economic elite capture of politics and bureaucracy has to be considered.

Theoretically, the study challenges the popular preconception of corruption as the major obstacle to efficient tax collection. It suggests that the degree of power concentration in a state is more decisive; corruption is a secondary problem. The study further presents evidence, that the characteristics of power concentration and change management are highly significant in explaining the outcome of tax administration reforms.

Undoubtedly, the study also has several limitations. Inherent in the approach taken, it cannot claim to present "the truth". Informal institutions as a matter of fact are difficult to observe even more to analyse. Many, such as corruption and collusion, patronage and clientelism, are hidden activities. As usually both sides involved in deal-making benefit, it is not in their interest to have these activities exposed to the public. Thus it is difficult to obtain knowledge on practises, to measure their extent, and gauge their impact. Nevertheless, this study argues, that evidence is all there if one cares to search and that it is sufficient to describe a representation of reality which is closer to "the truth" than the representation of reality one would reach by analysis of formal institutions only.

Related is the issue of obtaining comprehensive and reliable statistical data. While the most basic economic statistics could be obtained easily from international organisations' databases, the collection of statistics on tax collections and the tax administration proved a major challenge. The issue was not only that tax-related data is often regarded as sensitive, but more that the local authorities, quite common for developing countries, also did not even have the aggregated information readily available. When information was available the data regularly differed from institution to institution, sometimes even in reports from different years published by the same institution. Difficulties multiplied when an attempt was made to transform collected data to a common base so that a direct comparison between Indonesia and the Philippines would be possible. It turned out that both countries apply different definitions, e.g. on what is counted as taxes collected by the national tax authority and who is considered a registered taxpayer. Also, data collection methods and processing strategies of the authorities vary.<sup>10</sup> Therefore, it was impossible to transform the data without risking serious distortions. While constraining direct inter-country comparison, the decision was made to use the original data. This allows for the highest degree of

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<sup>10</sup> Government definitions also differ from the International Monetary Fund's (IMF) Government Finance Statistics (GFS) definitions. Only in April 2012, the IMF introduced a new initiative, the Revenue Administration's Fiscal Information Tool (RA-FIT), which in the long-term aims to create a database that provides "a consistent set of global revenue administration baseline data". According to the IMF (2012) first aggregated baseline indicators will be published in 2013. Publication is pending.

reliability, albeit limited to the quality of original data<sup>11</sup>, and for intra-country comparison over time, which is important for establishing the likely effect of tax reforms.

Another possible limitation concerns the interview and focus group material. Field research in Indonesia and the Philippines was conducted between February and June 2009. The atmosphere in both countries was very distinct and might have had an influence on the responses the interviewees gave. While in Indonesia people were euphoric having been praised for their achievements, in democratisation at large and in tax administration reform in particular, and the upcoming re-election of President Susilo Bambang Yudhoyono promising further reforms, in the Philippines people were deeply frustrated with their government. The Philippines had been experiencing a democratic regression as President Gloria Macapagal-Arroyo in her struggle to stay in power made every effort to place her people in strategic positions, including those that were supposed to keep the executive in check, please her allies, and silence opposition. Moreover, right when the field research in the Philippines started, a controversy involving the World Bank had broken out as a report on corruption in a multi-million roads project, alleging Arroyo's husband and other senior executives of being engaged in bid-fixing, had leaked to the media.<sup>12</sup> The reaction that followed, shifting blame from the blameworthy to the messenger, once again scared Filipinos that criticism of the government could have negative repercussions and provided yet another indication of the questionable legitimacy of Arroyo's government.

The impression the author gained during field research in Metro Manila was that people either declined to be interviewed or were very critical. For instance, an interviewee felt inclined to comment, "How do you beat that system? You line them up in one row and shoot them all; — but you cannot do that". Such attitude characterised many interviews conducted in the Philippines, hence, while all interviewees were well educated and could be expected to be objective and rational, it might have been that the comments gathered were biased towards the negative. On the other hand, it might have been that the comments gathered in Indonesia were biased towards the positive.

In analysis and writing, the author made every effort to verify claims and check statements against other data. Further, towards the final stage of the study, the author worked as a consultant to the International Tax Compact. The field missions to Indonesia and the Philippines and the subsequent collaborative writing of the reports allowed for a concluding assessment of the data. Thus, there is reason to believe that the study provides a reasonable picture of the state of tax administration in Indonesia and Philippines. Notwithstanding, the reader should keep in mind that the study is one

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<sup>11</sup> It is unclear how accurate the data provided to the public is. Bad collection methods, measurement errors or deliberate data manipulations may impede their quality (cf. Michalski/Stoltz 2013). Here, if no evidence strongly suggesting the contrary had been found, it is assumed that data, to the best of the national government's knowledge and capacities, is accurate.

<sup>12</sup> For more information on the controversy, see ABSC and PDI 12.02.2009, Senate 22.01.2009.

interpretation of the political economy of tax administration reforms in these two countries; it does not claim to be “the representation of the truth”.

Finally, with this study having an interdisciplinary character cutting across formal disciplinary boundaries, it follows that not all specific interests of individual research communities can be satisfied to the fullest. For instance, while in tailoring the theoretical and conceptual framework the study borrows some ideas from the “developmental state” debate, it is beyond the study’s scope to substantially engage with and contribute to the debate. This study is limited to the taxation domain. It neither provides general explanations of economic growth nor explains the general socio-economic development in the two case studies. Relatedly also, the study is limited to analysing the impact of the factors observed in the case studies on taxation and tax reforms. Hence, the study also does not engage in-depth with the area studies’ debates on particularities of regime and elite development over time (for related references see FN 19). Separate analyses would be necessary to further explore these issues.

The study does not have the ambition to be comprehensive, its objectives are limited to reach a better understanding of the shortcomings and weaknesses in taxation in Indonesia and the Philippines and the reasons why reform experiences differ.

## **1.4 Structure of the Dissertation**

The introduction has described the background and importance of the study. What remains is to outline what lies ahead. Following this introduction, Chapter 2 discusses the conceptual framework of the study. It provides a brief overview of the state of research in the political economy of public administration reforms and presents the main theoretical concepts underlying the empirical study.

Chapter 3 outlines the analytical framework. It provides the arguments for case selection, describes the research methodology applied, and operationalises the independent and dependent variables of this study.

Chapters 4 and 5 constitute the empirical centrepiece of this study, analysing in detail the Indonesian Directorate General of Taxes and the Philippine Bureau of Internal Revenue, respectively. Both chapters are organised along similar lines to allow for structured comparison. All elements regarded as necessary for a meaningful political economy analysis are covered: the context, institutions, actors, and processes. The chapters proceed in five steps: first they describe the national context of reform, second the administrative conditions of reform, third the process of reform, fourth the indicative outcomes of reform, and finally a concluding section aims to synthesise the main findings of the case study. This serves to assess why tax efforts are likely to have been the way they are and why the country has followed the reform path it has followed.

Chapter 6 brings together the two case studies’ results. It summarizes what the individual case studies have found out and compares these insights gained to each other. Finally, it draws implications for policy and scholarship, and suggests directions for further research.



## 2 Conceptual Framework

What are the shortcomings and weaknesses in taxation in developing countries and why are some countries more successful than others in introducing reforms to strengthen their tax system? Answering these theoretically attractive and practically important questions is a challenging task. The present study's theoretical assumptions, the research design, empirical investigation strategies, and conclusions have been developed in relation to insights gained from previous studies. This chapter provides an overview of the state of research and introduces the main concepts applied in this study.

### 2.1 Political Economy of Public Administration Reforms

Defining the object of the study stands at the forefront of each analysis. What constitutes the public administration and what is understood as a reform? So far, no consensus on either of the terms exists. Literature review elicits numerous definitions. These vary in detail and in the focus attributed to particular aspects of the whole. The shared denominators are 'state organisation' and 'change'.

These two aspects reflect in the definitions applied in this study. Public administration is understood as encompassing the governmental agencies and organisations managing the relationships of the state and society. Reforms on the other hand are defined as deliberate and purposeful attempts, often challenged by external and internal resistance, to amend or transform administrative structures, processes, and attitudes which are regarded as inappropriate, inadequate or inefficient, into something more amenable and conducive for achieving common goals.<sup>13</sup> In this sense, reform carries both a controversial positive and normative notion.

As the tax administrations studied are part of the public administration system, tax administration reforms are regarded as a particular form of public administration reform. Hence, it is assumed that the theories applicable to the analysis of general public administration reforms are applicable also to specific tax administration reforms.

Reforms in the public sphere caught considerable attention of practitioners and scholars from various backgrounds and disciplines. There is an abundance of literature on both first-generation and second-generation reforms in developed countries. Since the outset of the new public management paradigm in the last quarter of the twentieth century, studies of specific individual public organisations have increased in particular

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<sup>13</sup> This definition follows a combination of Caiden's (1969: 65; 1991) classic and Quah's (1976: 58; 2011) Asian experiences inspired definitions of reforms as "the artificial inducement of administrative transformation against resistance", "a deliberate attempt to change both (a) the structure and procedures of the public bureaucracy (i.e. reorganization of the institutional aspect) and (b) the attitudes and behaviour of the public bureaucrats involved (i.e. the attitudinal aspect), in order to promote organisational effectiveness and attain national development goals".

(Flynn/Strehl 1996; Lane 1997; Pollit/Bouckaert 2004; Lynn 2006).<sup>14</sup> For the study at hand, insights gained from these studies are of relevance on a general level. Yet, due to their very different circumstances, they are of reduced applicability only on a more profound level. They point to general aspects that deserve attention, yet naturally they neglect specific aspects relevant to developing countries.

Only more recently, interest in analysing reforms in the public realm of developing countries has grown. The main reason has been the frequent observation that in reform attempts there is often a gap between the theoretical dimensions of the good governance and new public management paradigms, the application of its principles, and the actual achievements of reforms. This motivated academics and practitioners to pay more attention towards the critical assessment and analysis of public administration reforms.

As indicated earlier, despite a slow growth in recent years, there remains a scarcity of studies on tax reforms. Public financial management literature so far has concentrated on the expenditure side of the budget, the revenue side has been largely neglected. Due to differences in the logics and strategies applied in both domains, insights from expenditure side analysis are not directly transferable to studies of the revenue side. These studies are thus similarly only of limited applicability for this study.<sup>15</sup>

Research on the revenue side is still in its infancy. This study takes up the challenge. Earlier works on tax reforms aimed to gain an overview (Gillis 1989b; Tanzi 1991; Bird/Casanegra de Jantscher 1992), later studies concentrated on the implications of taxation for state governance (Bräutigam et al. 2008; Everest-Phillips 2010) and the development of detailed case studies. Research on Sub-Saharan African cases is most frequent (von Soest 2009; Prichard 2010b; Fjeldstad/Heggstad 2011, 2012). Research on Latin American cases follow (Taliencio Jr. 2004; Sanchez 2011); whereas research on Asian cases is lagging far behind.

The state of academic literature on taxation and tax reforms in Indonesia is particularly thin. With regard to the tax administration partly it is thirty-year-old literature, which presents the state of research (Oberndörfer et al. 1976; Lerche 1978, 1980). The situation has improved only very slowly, with few studies published (Mookherjee and Das-Gupta 1998: 413-430; Brondolo et al. 2008; Rizal 2012). By the time of writing research had been fostered as the Indonesian government has made use of international scholarships offered and seconded several tax officials to pursue PhD studies abroad; predominantly at Japanese and Australian universities. Yet, it remains to be seen how much of this research is finally published. The state of literature on taxation in the Philippines is better, yet here the analysis of tax policies dominates research (Manasan 2004; Diokno 2005; Reside 2006; Sicat 2011; Nakayama 2012). Research explicitly

<sup>14</sup> NPM's focus has been on promoting more business-like principles in administrative organisation and processes to augment the efficiency, effectiveness, and fairness of the public administration (Poldiano 2001; cf. McCourt/Minogue 2001).

<sup>15</sup> This is also the impression the author gained during field research for the research project "Persistence and Change of Neopatrimonialism in various Non-OECD Regions". Information obtained on issues pertaining to the expenditure side, that is budget preparation, procurement and the education system, showed distinct divergences from information gained related to the revenue side.

analysing the tax administration remains sparse (Briones 1979; Klitgaard 1988; Fabella/Chua 2011). A comparative study of Indonesian and Philippine taxation, to the best of the author's knowledge, is non-existent.

The complex pattern of reforms "has created immense difficulties for theorists seeking to explain the genesis of public sector change and its transformation over time" (Wallis et al. 2007: 1). This has been particularly true for the analysis of tax administration reforms. The following paragraphs illustrate the challenge.

Initially the so-called "ignorance perspective" prevailed. This perspective regarded taxation and tax reforms predominantly as a technical exercise, where simply the right knowledge was missing thus had to be transferred to transform the developing administrations (Gillis 1989b; Bird/Casanegra de Jantscher 1992; Thirsk 1997). Reforms would occur when sufficient economic pressures have built up (Burgess/Stern 1993). Political, historical, and institutional underpinnings were largely ignored. As few economic issues have proven to be as eminently political as taxation, these theories hold serious deficiencies. Structural economic factors and the introduction of certain "best practices" may well be important factors influencing the success of domestic revenue collection, yet they are unable to fully explain why taxes are collected in a certain way and why reforms occur the way they occur when they occur. As experience has shown, the fulfilment of certain conditions does not necessarily lead to predicted or intended results.

Increasingly both academics and practitioners acknowledged that merely understanding what is wrong within the particular organisation to be reformed and the subsequent introduction of a fitting best practise solution from the administrative systems engineering toolbox does not necessarily lead to intended outcomes. These acknowledgements strengthened perspectives which regard reforms as part of, thus influenced by a broader societal framework.

Culturists pointed to the values and beliefs of individuals. The ability of governments to collect taxes depends on the willingness of its citizens to participate. "Tax culture", including tax morale and tax discipline, of taxpayers and tax collectors may both be intrinsically and extrinsically motivated. Certain traditional values and religious beliefs may be more compatible with taxation than others; perceptions of taxation's legitimacy and fairness may lead to greater acceptance and thus larger voluntary contributions (Slemrod 1992; Feld/Frey 2002).

Rational-choice behaviourists emphasised individual decision-making. Rational thinking individuals would always choose those options, which are most likely to maximise personal profit and shift potential burden on others. Individuals are conceived entirely free in making their choices (Levi 1988). Thus generally strategic considerations rather than technocratic economic considerations shape the tax system and influence the characteristics of reforms.

Again, these theories may well point to important factors influencing the success of domestic revenue collection and tax reforms, yet there is sufficient evidence that they

fail to provide fully convincing explanations. There is evidence that there are no specific factors, which are always propitious or detrimental. Success factors are highly contingent, thus broader frameworks are needed. In consequence, building on insights gained from the various strands of literature, more sophisticated “political economy frameworks”, focusing on relations between political and economic processes, have gained in prominence. Since the early 2000s, also the international organisations, which earlier advocated “technical solutions”, have begun to engage in the development of new approaches and measures.<sup>16</sup>

Political economy analysis “explores the links between a structural context for an intervention, the key stakeholders affected, and the influence of institutions on stakeholders’ opportunities and incentives for action” (Copestake/Williams 2012: 1). Understanding the environment in which the administration is embedded helps to identify the factors likely to be conducive to and those likely to be constraining reforms. Ideally, through in-depth political economy analysis it would be possible to explain why change happens, what explains the scope, sequencing, and pace of implementation, as well as the observable outcome. These insights gained then could in turn feed into the development of future strategies.

Among political economists, there is almost unanimous agreement that it is institutions, most popularly defined as the rules of the game, including “any form of constraint that human beings devise to shape human interaction” (North 1990: 4), that matter (for a more detailed elaboration see Chapter 2.2). There is wide-agreement that development has greater chances to succeed when the configuration of the institutional environment is conducive. It is reasonable to presume that this general assumption applies also to the introduction of welfare-enhancing reforms. Overall, the implementation and enforcement of an effective and efficient, equitable and impartial tax system is regarded as welfare-enhancing. Thus, in building a framework for this study, it is suitable to borrow some ideas from previous work on the developmental state.<sup>17</sup>

Three influential frameworks are highly relevant for this study: Hutchcroft’s (1998) typology of state apparatuses and capitalism building, North, Wallis and Weingast’s (North et al. 2009a, 2009b) theory of social orders, and Acemoglu/Robinson’s (2012) typology of economic and political institutions.

Hutchcroft argued that the major obstacle for sustained development lies in the political sphere. A careful examination of the relations between the state and dominant economic

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<sup>16</sup> DFID’s (2003) ‘Drivers of Change’ approach is a prominent early example, while the World Bank’s (2008a; Fritz et al. 2009) ‘Governance and Political Economy Analysis’ is a later one. Only recently, the World Bank (2012b) adopted a new ‘Public Sector Management Approach’ which reflects political economy considerations.

<sup>17</sup> This study borrows from the “developmental state” debate, yet it does not contribute to the explanation of economic growth. Economic growth and taxation are indirectly related only (see Chapters 1.1 and 3.4.3). Moreover, “[t]he historical evidence suggests that state capacity varies substantially across functions and sectors *within* polities.” (Di John 2008: 84). Therefore, while some scholars assume a virtuous circle of taxation, no direct inference from the state of taxation on the general developmentalism of a state should be made.

interests would reveal these obstacles. Distinguishing between “patrimonial oligarchic states”, which he identified as countries like the Philippines, where

the dominant social force – an oligarchy – has an economic base quite independent of the state apparatus, but the state nonetheless plays a central role in the wealth accumulation

and a form of “booty capitalism” emerges, and “patrimonial administrative states”, which he identified as countries like ‘New Order’ Indonesia, where “the dominant social force is a bureaucratic elite” engaging in “bureaucratic capitalism”, Hutchcroft (1998:52f) suggested that reforms are easier implemented in patrimonial administrative states than in patrimonial oligarchic states.

North, Wallis and Weingast (2009a: 53) distinguished between “limited access orders”, they also call natural states, where the state is dominated by a coalition of elites and those “people outside the coalition have only limited access to organizations, privileges, valuable resources and activities”, and “open access orders”, where the state is “open to everyone who meets a set of minimal and impersonal criteria”. While in limited access orders rents are created through the use of privileges, open access contributes to the erosion of rents. Moreover, open access orders have the tendency to easier discard “bad ideas” (ibid: 63). In the logic of change, these presumptions imply that reforms are easier conducted in open access than in limited access orders.

Acemoglu and Robinson (2012) analysed the distribution of power in societies and distinguished between extractive and inclusive economic and political institutions. These they argued have emerged in the past, and have the tendency to persist, shape the present and the future. While arguing that economic institutions are critical for determining the developmental state of a country, they claimed, “it is politics and political institutions that determine what economic institutions a country has” (ibid: 42f). “Extractive institutions” are dominated by a narrow elite which designs political structures and governance processes in a way benefiting them, paying little more than strategic attention to the potential cost to be borne in consequence by the public. In contrast, “inclusive institutions” distribute power broadly in society, encourage participation of and provide economic opportunities for the grand masses (ibid: 74-79). Following the goals of personal enrichment and power maintenance or augmentation, the narrow dominant elite, which has emerged from extractive institutions, may choose “to get it wrong” (ibid: 68). Inefficiency as such may not be a matter of mistake or ignorance but of choice. Welfare-enhancing reforms, their theory suggests, are more likely to be adopted and implemented in environments where inclusive institutions prevail; in environments where extractive institutions prevail only when the dominant economic elite perceives personal advantages and benefits through change.

While the labels in the theories of Hutchcroft, North, Wallis and Weingast, and Acemoglu and Robinson, differ, all three have in common that they pay particular attention to the past, institutions evolved and the rulers of the state. This study follows taking a comprehensive view of institutions, including formal and informal institutions and their particular strengths, and actors, including their distribution of power. Elite capture of politics and bureaucracy is of prime interest to this study.

In light of reported cases where all circumstances seemed ‘right’, yet no reforms could be implemented, and cases where all circumstances seemed ‘wrong’, yet reforms were successfully implemented and pursued, actors are regarded as decision-makers, whose space for decision-making albeit is bound by the existing institutions. It is assumed that it is the dynamics between them, which influence whether the path continues to be followed or a different direction than the predicted is taken. To capture this complexity, suitable analytical lenses whose scope includes the ability to bring special attention to the presumed relevant aspects need to be chosen. This requirement is met by historical institutionalism and the neopatrimonialism concept introduced below.

## 2.2 Historical Institutionalism

New institutionalism, “one of the most important innovations in the contemporary study of politics” (Bates 2007: 174), has gained prominence in analysing institutions and institutional change within the sub-disciplines of comparative politics, comparative political economy, and public policy. There are three main variations of the approach: rational choice institutionalism, sociological/cultural institutionalism and historical institutionalism. They share the belief that institutions structure politics, but vary in ontological presumptions on structural determinism and agency (for a review of the variations see Hall/Taylor 1996). Historical institutionalism is widely regarded as the most open variation. Due to its abilities to generate new in-depth information and capture complex social phenomena, it has become the approach of choice for scholars involved in the search for answers to empirical puzzles in under-researched areas. In historical institutionalist research “... explaining specific real world outcomes” (Steinmo 2001: 463) is a central motivation.

For historical institutionalists, institutions include both formal and informal institutions.<sup>18</sup> Institutions as the “rules of the game” (North 1990: 4) constitute “a regularized pattern of interaction that is known, practised, and accepted (if not necessarily approved) by actors who expect to continue interacting under the rules sanctioned and backed by the pattern” (O'Donnell 1996: 34). Formal institutions are defined as codified rules and regulations, structures and procedures, which have been formally created, are publicly communicated and easily accessible, as well as state-enforced. Informal institutions on the other hand are defined as “socially shared rules, usually unwritten, that are created, communicated, and enforced outside of officially sanctioned channels” (Helmke/Levitsky 2004: 727, emphasis removed). They can be both legal and illegal. Informal institutions are based merely on their existence and effectiveness. Practised largely outside of the public eye, capturing them is a complicated undertaking (Lauth 2000: 24-26).

Institutions structure politics, as they define who is able to participate in a particular political arena and a particular political decision, shape actors' preferences and interests,

<sup>18</sup> This stands in contrast to “old institutionalism” which concentrated upon the analysis of formal institutions, including the constitutionally organised organs of the state, intermediary organisations, and the fundamental formal norms and processes and principles of state.

and influence what actors perceive as feasible options worth pursuing. Institutional analyses emphasise the contingent nature of politico-economic developments. Rather than pointing to particular variables, “institutional analyses focus on illuminating how different variables are linked” (Thelen/Steinmo 1992: 13).

The dichotomous distinction between formal and informal institutions is idealised; in real world situations both formal and informal institutions generally occur together. No country, not even the most liberal democracy, is ruled only by formal institutions. To understand the possible implications they carry it is hence necessary to understand the individual strengths, their stability and enforcement, and the relationship between formal and informal institutions (Levitsky/Murillo 2009). According to Helmke and Levitsky (2004), informal institutions may be complementary, accommodating, competing, or substitutive to formal institutions. Informal institutions can modify the way formal institutions work and shape formal institutional outcome. They can exert a positive, neutral, or negative impact on the quality of governance. An analysis of both hence is necessary to understand and explain the “real functioning” of the state. Of particular interest is here the discrepancy between behavioural norms of formal institutions and the actual behaviour of individuals.

Development paths, legacies, path dependencies, and process-tracing are prominent features in historical institutionalism conceptions. Central is the assumption that present observations can be accurately explained only through historically-based analysis. In-depth understanding of institutions would facilitate the identification of long-term structural problems, which reflect in many current challenges and shortcomings. What is observed as the outcome of a particular event may not be the result of this individual event but the outcome of a long process of events along the country’s development path. In shorter-sighted isolated single event analyses “important outcomes may go unobserved, causal relationships may be misunderstood, and valuable hypotheses may never receive consideration” (Pierson/Skocpol 2002: 6). This particular strength of historical institutionalism however has also been its main point of criticism.

Based on historical institutionalism’s presumption that institutions are comparatively stable over time, it has been criticised for a tendency towards overly static analysis. Historical institutionalism’s explanatory capacity was biased towards persistence and continuities. It would fall short in making sense of change-related phenomena be it incremental or drastic as found in critical junctures (Peters 1999, 2009). The long dominant ‘punctuated equilibrium model’ (see Givel 2010), viewing change as predominately introduced through exogenous shocks, would overemphasise institutions and give too little attention to endogeneity and the role of ideas and human agency (Liebermann 2001, 2002; Katznelson/Weingast 2005). A great deal of theoretical and methodological debate has emerged since aimed at refining and adapting the historical institutionalism approach to better understand the mechanisms of institutional change. In this course, the emphasis on the primacy of institutions was abandoned and actors gained in importance over institutions.

Several scholars have argued for a new approach, the “constructivist or discursive institutionalism”, to bring agency back in (Blyth 2002; Hay 2004; Schmidt 2008, 2010). Central is the presumption that “Ideas give substance to interests and determine the form and content of new institutions” (Blyth 2002: 15). It is “the ideas that actors hold about the context in which they find themselves rather than the context itself which informs the way in which actors behave” (Hay/Rosamond 2002). While constructivist institutionalists, as earlier historical institutionalists, caution that ideas, respectively institutions, are never the only cause of outcomes, constructivist institutionalism deserves equal criticism as traditional historical institutionalism for privileging ideas, as historical institutionalists did earlier with privileging institutions. Logically, it is reasonable to conclude that research wherein ideas/institutions explain virtually everything, they may explain actually almost nothing.

An actor-centred historical institutionalism, as suggested by scholars like Steinmo (2008) and Bell (2011), has the potential to consolidate both views. It gives equal importance to both institutions and actors, assuming an evolutionary dynamic interaction between structure and agency. Agents are conceptualised as active, interpreting and strategizing individuals operating “with variable and contingent degrees of constraint and empowerment within institutional settings” (Bell 2011: 893). Institutions shape human behaviour whilst in turn human agency reproduces or transforms institutions over time. The analysis of formal and informal institutions in relation to the distribution of powers and power relations among actors in a state and within the particular political arena which stands at the focus of research interest, promises a well-rounded account of issues and events. This study aims to reach precisely this. Therefore, based on an actor-centred historical institutionalism approach it will take account of both actors and institutions relevant to taxation and tax administration reforms in the two case studies analysed.

### **2.3 Neopatrimonialism Concept**

The main analytical lens applied to this study is that of neopatrimonialism. The neopatrimonialism concept has found the widest application in the African context, as various Africanists have found it particularly attuned to depict the exercise of authority in the politics and bureaucracies they were observing (Médard 1982; Clapham 1985; van de Walle 1994; Chabal/Daloz 1999). Belief spread that “the distinctive institutional hallmark of African regimes is neopatrimonial” (Bratton/van de Walle 1997: 277). According to Leonard and Straus (2003: 5), neopatrimonialism “has become the standard for understanding African politics”. However, the application of the concept has not been confined to the region. As a general concept it also found reflection in studies of Latin American, Southeast Asian, Middle and Far Eastern, communist and post-communist European, and Central Asian societies (e.g. Bach/Gazibo 2012).

Being widely used it has not been uncontested however. For instance, Erdmann/Engel (2007) criticised it as elusive and in danger of becoming a “catch-all concept”, in some cases entering the argument as a “*deus ex machina*” (ibid: 113f, cf. Theobald 1982: 555;



Erdmann 2012). Similarly, Therkildsen (2005) and Pitcher et al. (2009) questioned the analytical utility of the concept on its own, arguing that many scholars working with the concept tend to overlook, downplay, or even ignore other structure- and human-related factors, leaving neopatrimonialism as a term used for all sorts of ills and troubles found in developing countries. Still, even its staunchest critics admit that the concept holds value and does make sense when properly defined and well applied. This study presents a case in point, arguing that neopatrimonialism can not only be applied to Southeast Asia, but, as an analytical lens and one variable among a set of different independent variables (see Chapter 3), is also well suited for analysing and explaining public sector performance and public administration reforms not least in developing countries. It is able to highlight both formal and informal institutions as well as the distribution of power in relevant actors, and permits these to be put into relation.

By denoting the simultaneous operation of the patrimonial and the legal-rational rule within one system the concept of neopatrimonialism, first coined by Eisenstadt (1973), builds on Max Weber's sociology of domination. In his conception of the modern state, Weber (1978 [1922]: 212-245) distinguished between the ideal type of rational-legal rule – denoting a clear separation between the public and the private sphere, where rational-legal authority follows clearly specified procedures, i.e. is rule-bound and depersonalised – and the ideal type of patrimonial rule, as a subtype of traditional rule – denoting the missing separation between the public and the private sphere, meaning that all power relations, political as well as administrative, between the rulers and the ruled, are essentially personal in nature. In a neopatrimonial system, the legal-rational framework exists and is accepted, yet is contested by patrimonial practises. In other words, formal and informal institutions coexist. The distinction of the public and the private realm, connoting the “modern” state, is blurred (Erdmann/Engel 2007: 105).

This study treats neopatrimonialism as a form of domination rather than a regime type of its own. It is not the mere existence of patrimonial/informal elements, which as has been pointed out earlier do exist in any regime, but its scope and depth, degree and strength over legal-rational/formal elements which qualify a system to be characterised as neopatrimonial. Reliable benchmarks do not exist; there is broad agreement however, that patrimonial practises should be deeply rooted, widespread and entrenched for a system to be classified neopatrimonial. As such neopatrimonial rule is predominantly encountered in authoritarian and hybrid regimes. It would even be reasonable to argue that neopatrimonialism, implying a substantial degree of patrimonial rule and a high degree of related uncertainty, is incompatible with liberal democracies. Patrimonial elements may exist, but the extent is insufficient to classify the system neopatrimonial. With regard to the two country cases of this study, Indonesia and the Philippines, there is sufficient evidence that neopatrimonial rule, despite democratisation, the dismantling of big-man rule as formerly embodied by the autocrats Soeharto and Ferdinand Marcos,

and decentralisation, continues to persist (Hutchcroft 2008; Quimpo 2009; von Luebke 2010; Blunt et al. 2012). What changed are its particular characteristics only.<sup>19</sup>

As indicated above, various scholars identified neopatrimonial governance as the main variable explaining development deficiencies and state weaknesses in a number of countries of various world-regions. Variances in public sector reform progress in this regard have been related to differences in shape and degree of neopatrimonial domination and the influence this has on policies and administrative operations (O'Neil 2007). For instance, van de Walle (2004) argued that the key to an understanding of the course of reform attempts lies in the nature of political power. Kjaer (2004) and Taylor (2006) followed this argument by claiming that neopatrimonialism presents a limiting factor often blocking reform attempts, yet at the same time they cautioned that it cannot account for why selected reforms can happen amidst environments one would predict to be rather hostile to reforms. Kelsall et al. (2011) took this idea up and suggested that there is a need to distinguish between different forms of neopatrimonialism. Some forms of neopatrimonialism may be more conducive to the implementation of welfare-enhancing reforms than others. These presumptions fit in well with the categorisations developed in regard of the relation between informal and formal institutions (see Chapter 2.2). Patrimonial practises do not equal bad governance; they similarly can be supporting pillars to legal-rational government. Bach (2011: 290) therefore seems right when he concluded that “The developmental trajectory of the different waves of emerging countries is a powerful reminder that neopatrimonialism ... does not predetermine outcomes”.

The challenge lies with not only identifying what impedes the capability to collect and what blocks reforms, but analysing also whether there are certain configurations and constellations which are likely to be more favourable for reforms aimed at reaching more effective and efficient, equitable and impartial tax systems to be initiated and implemented, to progress and succeed, than others.

The most common operationalisation of neopatrimonialism is three-dimensional: concentration of power, systematic clientelism, and particularistic use of state resources (Bratton/van de Walle 1997: 63-68, for more details on the operationalisation and the elaboration of indicators identified for each of these dimensions see Chapter 3.4.1). It is within these three dimensions, in relation to the other explanatory variables identified, where variances in neopatrimonialism can be traced.

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<sup>19</sup> A major advantage in using neopatrimonialism, rather than related concepts, such as “cacique democracy” (Anderson 1988), “patrimonial oligarchic/administrative state” (Hutchcroft 1998), “sultanism” (Chehabi/Linz 1998), “bossism” (Sidel 1999), “clientelist electoral regime” (Franco 2001), “crony capitalism” (Kang 2002), “collusive democracy” (Slater 2004), “patrimonial democracy” (Webber 2006), “patronage democracy” (van Klinken 2009b), “predatory regime” (Quimpo 2009), oligarchy (Winters 2011), cronyism, patronage politics or money politics, to name only a few, is that the concept allows for better comparison over time.

### *Research Hypotheses*

Focusing on the time period from year 2002 to 2010, this study seeks to answer two empirical questions: What accounts for the shortcomings and weaknesses in taxation in Indonesia and the Philippines? What are the reasons why reform experiences differ?

Pertaining to these questions, putting together the individual parts of the conceptual framework, the following assumptions and research hypotheses can be derived:

The leading assumptions of the study are that taxation is a fundamentally political issue and that taxation is not in the interest of elites when it threatens their vested interests. The term “elite” is used narrowly, to encompass the countries’ most wealthy oligarchs and clans. The economic elite “will not deemphasize their narrow factional interests on behalf of broader class interests except under extreme duress” (Slater 2010: 13).

Thus the central argument is that legacy-driven variations in neopatrimonialism are highly influential in determining the shape and direction of the tax system. Variations in neopatrimonialism’s first dimension power concentration are of particular relevance. The dimension does not stand equal to the other two dimensions, but exerts influence on the other two dimensions’ observable characteristics. Systematic clientelism and the particularistic use of state resources serve to increase and foster power concentration.

Power concentration refers to the degree of elite capture of politics and bureaucracy. The more power, therewith influence and control the economic elite has on these two central domains of the state, the more it is able to introduce and sustain policies and actions in their favour. The expectation is that the countries’ wealthy prefer measures that keep their tax payments low. This reflects in the tax system and the characteristics of tax reforms. Path dependence implies that the system in place by and large is resistant to change. Yet, extant institutional and structural factors do not predetermine outcome. Human agents choose directions. Agency can overcome institutional constraints and hence lead to change.

The ensuing hypotheses therefore are:

*H1: The degree of power concentrated in the country’s economic elites influences the shape of the tax system. The stronger elite capture of politics and bureaucracy the less likely is an effective and efficient, equitable and impartial tax system.*

*H2: Variations in the scope of tax reform can be explained by variations in power concentration. The more direct influence economic elites exert on tax policies and the tax administration, the less likely are substantial tax administration reforms, the more continuity we can expect.*

*H3: Strong political will, leadership and a coherent mid- to-long-term strategy can overcome structural obstacles and introduce change.*

## 2.4 Summary

Analysing why administrations differ in performance and what causes variant degrees in reform success is a challenging task. Literature review indicates that no single individual factor can fully account for observable outcomes. A political economy analysis, comprehensively taking both institutions and actors into account, promises to deliver better results in determining the favourable and less favourable conditions for tax collections and tax reform. Hence, this is the route taken by this study.

In particular with regard to taxation, there are strong indications that both a long-term perspective and an analysis going beyond the legal framework are needed. Taxation is a fundamentally political issue. Taxes are highly contested in most societies. Tax avoidance and tax evasion are common causes for tax revenue loss. A low tax ratio may not be the result of a country's institutional destiny, but a matter of choice.

Following these considerations, actor-centred historical institutionalism has been introduced as the study's underlying theoretical approach, as it allows for an appreciation of long-term developments and of the interaction of both formal and informal institutions and actors. Neopatrimonialism further has been introduced as the study's main analytical lens as it is well suited to spotlight informal institutions. Variations in the neopatrimonial profile, in particular within the power concentration dimension are expected to be highly decisive in shaping the tax system, reform opportunities and prospects.

## 3 Analytical Framework

### 3.1 Introduction

For empirical research a shift from the theoretical conceptual framework towards a practical research strategy and a clear operationalisation of the variables is indispensable. This chapter describes the approach developed for the study. It outlines the analytical methods chosen, introduces the independent and dependent variables, and describes their operationalisation in detail.

### 3.2 Principles of Case Selection

Two main research paradigms are distinguished: qualitative research, associated with in-depth analysis of few cases, and quantitative research, associated with statistical analysis of many cases. The strongest point of qualitative research is specificity, while quantitative research's is generalizability (Ragin 1987). Reaching generalizability is tempting, however as so far little is known on taxation and tax reforms in developing countries, and few comparable data exists, quantitative large-N analysis is essentially precluded. This study thus applies a small-N qualitative research approach, albeit with some quantitative elements.

The method of choice is that of the case study. A structured comparison of two case studies serves to analyse the distinctiveness of the particular cases, and explore theoretical propositions which might constitute plausible explanations for differing development trajectories, and might at best also be valid beyond the particular cases studied. The emphasis of the study is on learning rather than proving (Eysenck 1976: 9, as quoted in Flyvbjerg 2011: 303).

In defining a case study the study follows Gerring (2004: 342) who defined it as "an intensive study of a single unit for the purpose of understanding a larger class of (similar) units". As Gerring (2007: 103) argued "case studies, if well-constructed, allow one to peer into the box of causality to the intermediated causes lying between some cause and its purported effect". George and Bennett (2005: 6-9) moreover argued that case studies are especially well suited for theory development. Comparative research of a series of case studies is capable of strengthening these arguments. The conscious and strategic selection of cases worth studying and examining in detail, however, forms a precondition. Random selection is prone to result in selection bias, which might lead to systematic error and false interferences (Geddes 1990, 2003; King et al. 1994; Collier/Mahoney 1996; cf. also Seawright/Gerring 2008).

With controlled experiments not a feasible option in the social sciences, quasi-experimental research designs are proposed. Przeworski and Teune (1970: 32-46) distinguished between the "most similar systems" and the "most different systems" research design. In the most similar systems design, cases sharing as many similar

features as possible except the dependent variable are chosen, whilst in the most different systems design, cases with as many different features as possible and a homogenous dependent variable are chosen. In case selection for this study the most similar systems design was adopted.<sup>20</sup> The logic behind is that with most contextual variables held constant, the number of possible independent variables causing the different outcomes is reduced. Hence, the potential for isolating causal relationships is increased (Nohlen 2002). Meanwhile, it has to be admitted that the problems of multiple variables, few cases, and multi-causality are real.

Case selection is theory driven; it is biased only in that far, that it restricts the universe of potential cases to countries located in Southeast Asia.<sup>21</sup> This decision was taken, as the research gap regarding taxation in this region is particularly large.

In selecting the cases, the following variables were controlled: autocratic past, democratic transition, regime type, state organisation, and territorial integrity. With heterogeneity characterising Southeast Asia, controlling for these variables reduces the number of possible cases from eleven to two, Indonesia and the Philippines. The prerequisites, tax reform experience and an assumption of prevalent neopatrimonial rule, are considered fulfilled by both countries. Both cases share a high degree of contextual similarity, see Table 3.1, and substantial differences. Most importantly both countries differ in the perceived reform success, with Indonesia widely perceived to have been the more successful.

TABLE 3.1: *Selected Case Studies – Similarities*

	Indonesia	Philippines
Autocracy	1967-1998 Soeharto	1972-1986 Ferdinand Marcos
Democratisation	21.05.1998	25.02.1986
Regime Type	presidential republic	presidential republic
State Organisation	decentralised	decentralised
Territorial Integrity	largely stable exception: Aceh (until 2005)	largely stable exception: Mindanao (until 2012)

*Source:* Author's compilation based on Macmillan's Statesman's Yearbook (2008).

The study explicitly focuses on tax administration, rather than tax policies, and the analysis of those tax administration reforms underway between the years 2002 and 2010. It concentrates on taxes administered nationally. These account for more than 90% of total taxes collected in both countries (NTRC 2011: 1; Arnold 2012: 6). Following theoretical assumptions of historical institutionalism, predominantly in describing the historical genesis of the tax authorities and the situation of tax administration before the introduction of reforms, the study nevertheless goes back as

<sup>20</sup> The most similar systems design closely resembles Lijphart's (1975) "comparable cases strategy" and Sartori's (1991) "most similar strategy".

<sup>21</sup> This study defines Southeast Asia as the ten member states of the Association of Southeast Asian Nations (ASEAN): Brunei Darussalam, Cambodia, Indonesia, Lao PDR, Malaysia, Myanmar, Philippines, Singapore, Thailand, and Viet Nam; plus Timor-Leste.

far as possible and relevant. Similarly, in evaluating reform outcomes, analysis considers data and events until the end of year 2012.

While the concentration on reforms which just happened or are still in progress, does have the disadvantage that the extent and sustainability of the outcome cannot be fully appreciated, as effects take longer than can be captured by the study, it also has major advantages the study seeks to capitalise on. Getting access to authorities and interview partners is easier as a larger number of people still care about the issue at stake. Moreover, recent developments are easier and more accurately re-constructed, as data are better available and memories of respondents are fresh. Therefore, it is expected that the quality and outreach of the results is increased.

### 3.3 Research Methods and Sources of the Study

The study is informed by the analysis of a wide variety of sources. Secondary sources serve to establish the theoretical background, describe the context of tax administration reforms, re-construct past developments, and put research findings into perspective. In analysing the Indonesian and Philippine cases, due to the very limited existence of relevant research, the study relies heavily on evidence gathered from primary sources. Primary sources serve to describe recent issues and events, and deepen the understanding of informal institutions, and their relations to formal institutions. Empirical information has been collected in the form of quantitative and qualitative data. Quantitative data was retrieved from both international and national datasets, perception surveys, as well as collected directly from government agencies. Qualitative evidence largely stems from the detailed analysis of 90 semi-structured expert interviews and four focus group discussions realised during field stays in Indonesia and the Philippines. In addition a large body of primary written sources was collected.

Field research was conducted in the Philippines from February 2<sup>nd</sup>, 2009 to April 8<sup>th</sup>, 2009 and in Indonesia from April 9<sup>th</sup>, 2009 to June 21<sup>st</sup>, 2009.<sup>22</sup> In both countries, the author was an invited visiting research fellow with the leading national universities, the University of the Philippines and the University of Indonesia. These affiliations were very helpful, as they did not only offer the opportunity for academic exchange, but opened doors and helped to establish contacts with government agencies, renowned experts and key stakeholders. Another set of interviews, which were not analysed in detail for this study but whose information was used for a concluding assessment of data completeness, reliability and objectivity, was conducted within the framework of the International Tax Compact's (2013) "Mapping taxation in selected Asian developing countries" study. As a consultant to the ITC, the author, together with three other team members, visited the Philippines from October 18<sup>th</sup> to 25<sup>th</sup>, 2012 and Indonesia from November 19<sup>th</sup> to 27<sup>th</sup>, 2012. As research focuses on the national level, data collection was restricted to the metropolitan city areas of Jakarta and Manila.

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<sup>22</sup> The Philippines were left right at the beginning of the Holy Week, when the whole country comes to a virtual standstill. Indonesia was entered on the day of the national legislative elections.

Interviews are powerful tools to understand the perspectives and behaviour of individuals in regard of issues the interviewees are personally involved in or do possess intimate knowledge of. They are particularly helpful in exploring issues, which have been understudied. The conscious selection of interviewees, thoughtful preparation of interview guides, and appropriate conduct of interviews, however are prerequisites to increase the likelihood of obtaining rich and meaningful data, which serve to answer the research questions (Weiss 1994; Kvale 1996; Legard et al. 2003; Ritchie et al. 2003).

Interviewee selection followed two principal considerations: first, to obtain a comprehensive picture, individuals belonging to different groups should be interviewed, and second, individuals to be interviewed should be or have been in strategic positions from which they have potentially been able to exercise influence on the reform process. In this sense, compared to the general public, individuals approached for formal interviews can be described as experts. Due to the sensitivity of the study, to protect the privacy of the resource persons, and to ensure the confidentiality of the data, the personal data of interviewees is not disclosed. Throughout the study, interview quotes are referenced only by respondent group identities.<sup>23</sup> The target number of interviews for each respondent group was predefined prior to the field research, ranging between five and seven for each group. The aim was to capture the range of answers and reach sufficient depth, while keeping research manageable. It turned out, that in some cases fewer interviews were needed, while in other cases more would have made sense. Overall, the choice of respondent groups and interviewees proved appropriate and reasonable to capture the richness and complexity of both the tax administration and the reform processes. Table 3.2, lists the respondent groups and details the number of formal face-to-face interviews conducted with each group.

TABLE 3.2: *Respondent Groups and Number of Interviews Conducted*

<b>Respondent Groups</b>	<b>Indonesia</b>	<b>Philippines</b>
Tax Officials		
a) Management Level	7	5
b) Middle Level	7	2
Other Government Officials	5	4
Business Representatives	6	5
Civil Society Representatives	6	6
Politicians	5	3
Social Scientists	4	7
International Organisations Representatives	9	9
<b>Total Interviews</b>	<b>49</b>	<b>41</b>

<sup>a</sup> Neither of the groups is to be seen as monolithic. Therefore, responses present individual perceptions and generally do not present the views of the entire group.

<sup>b</sup> In 2009, the author conducted another 16 interviews in Indonesia and 13 in the Philippines discussing a similar topic in regard of the national education systems. As many of these interviews contained interesting information on the national bureaucracies, while not counted as formal interviews for this study, these interviews serve as background information to the study.

<sup>23</sup> On ethics in qualitative research see Miller et al. (eds.) (2012).



<sup>c</sup> Interviews conducted by the ITC mission in 2012, not listed in the table above, complete the study, as similar respondent groups were approached and comparable issues in regard of taxation in Indonesia and the Philippines were discussed.

*Source:* Author's compilation.

Tax officials, due to the influence of hierarchy, were divided into tax officials with managerial powers and those at the middle level. The aim was to interview tax officials directly involved in devising and managing reforms, and to interview tax officials employed in a selection of different departments reflecting tax administration's core business processes. As interviews were to be conducted mainly at the head office, only tax officials from middle level upwards were included in the sample. The reason is that it was believed that these individuals, due to the regular rotation policies at the tax authorities, hold information which includes employment at regional and local tax offices, and most importantly that, due to their longer work experience, have a longer, more comprehensive perspective which would allow for process tracing.

As taxation is a sensitive issue, touching the core of the state, accessing tax authorities and gaining the trust of tax officials is a challenge. Formal requests detailing information on the researcher, her home institution, the sponsor, nature and purpose of the research, providing sample questions, and accompanied by supporting letters from the local universities had to be submitted. Getting access to the tax administration proved particularly difficult in the Philippines; the shortfall was attempted to be compensated by interviewing a higher number of social scientists familiar with the tax administration than targeted. In Indonesia, once access was gained and the formal consent of the central office given, most tax officials directly involved with tax administration reforms and employed in specific departments of interest could be interviewed. The point of saturation probably in both cases was not yet achieved. Time proved a serious constraint.

Establishing contacts and gaining the consent for interviews from individuals outside the tax administration was easier. The selection of interviewees initially followed hints collected from documents obtained prior to field research and advice provided from hosting local researchers during the first days of the research stay. Subsequently, interviewees were asked for further recommendations that could be followed up, in several cases interviewees themselves established further contacts. Interview requests were generally submitted via telephone calls and text messages, in short describing the researcher and the study conducted. In most cases individuals approached quickly decided to engage in the research, only few outrightly refused, and some played delaying tactics until the researcher left the country. The motivation to engage varied across a broad spectrum, including curiosity and a personal interest in the issue, the aim to influence public debate and academic discussion, and the altruistic motive of assisting a young researcher. Yet, overall, as the triangulation of information obtained from different sources has shown, regardless of the initial motivation, interviews did not show clear biases distinguishing one from others.

The respondent group of other government officials includes officials not directly employed with the tax authorities, but with the ministries of finance, budget and planning, and civil service agencies whose range of responsibilities directly relates to the tax administration. Business representatives, representing taxpayers, include business owners and chief executive officers of major companies related to chambers of commerce.<sup>24</sup> Civil society representatives were selected based on their experience and knowledge on public sector governance, corruption issues, and taxation. Politicians were another hard to interview group. Once they learnt that the author was interested in taxation, most politicians contacted, although members of the relevant parliamentary commissions, did shy away. Social scientists either were experts in public administration in general or more specific of the tax administration itself, originating from the disciplines of administrative sciences, economics, law, and political science. International organisation representatives were engaged either in governance issues in general or directly engaged with tax administration reforms as advisors, consultants or programme managers.

As long-term planning is uncommon in the Indonesian and Philippine culture, interviews often had to be arranged and rearranged from day to day. The interviewees suggested location and time. Most interviews took place at their offices, some preferred their homes, others public places. When possible interviews were conducted in the interviewee's mother tongue, this served to make it more comfortable for the interviewee and help not to lose meaning to translations. In this regard it proved advantageous that the author is fluent in Indonesian and that the Filipinos interviewed grew up bilingually, therefore were used to interact in English. Interviews were semi-structured and on average lasted about one hour and a half.

The interviews served to collect information on the following tax administration related issues: human resource management, business operations, administrative accountability, reform experiences, relations between the political and administrative level, and perceived prospects (for the interview guidelines see Appendix II). For each respondent group a separate interview guide was developed prior to field research. A set of key issues and sub-topics was covered across all respondent groups; in addition special questions relating to the individual expert knowledge of respondent groups were incorporated. Questions were structured logically from the general to the more specific.

Each interview was preceded by five to ten minutes of small talk, where the interviewer introduced herself, the purpose of the research, and described what will happen with the interview material. Due to the sensitivity of some topics to be discussed, interviewees were promised confidentiality. Quotations would be attributed only to group characteristics in later reports and publications. The official interview started with an introduction of the interviewee, which served to generate the personal context, which would be necessary to better understand responses and probe effectively. The interview guides were then followed as regards topics to be discussed, the structure however was

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<sup>24</sup> Opinions from the general public and ordinary taxpayers were collected from informal conversations throughout the field research and serve as background information.

flexibly adapted to the dynamics of the interview to smooth conversation and create the illusion of a natural flow. Also, if interesting subjects came up the interviewer had not thought about before, but which could be relevant, these aspects were further pursued. Interviews were closed with appropriate questions giving interviewees the chance to add anything they believed to be important but which did not come up during the interview. The main purpose was to end on a positive note.

With the consent of interviewees most interviews were recorded with a digital voice recorder. Among academics recording is a topic discussed controversially. Those who prefer to take notes argue that interviewees would feel intimidated by the recording device and were more likely to talk off the record, in particular if sensitive issues are discussed. Therefore, the author experimented with both methods. Notetaking during interviews was the greater distraction, negatively affecting the attention of both interviewees and the interviewer and disturbing the natural flow of conversation. The recording device on the other hand was quickly forgotten. It allowed both parties to concentrate on the interview and ensured that the interviewee's opinions were recorded as stated and not diluted by the author's interpretation at this early stage of research already. Human capacities to note down in detail while thinking about how to proceed and to later remember exactly what has been said are clearly restricted. The interpretation of fragments long after interviews were conducted is prone to misinterpretation. Moreover, by recording the amount of information gained significantly increased. In hindsight, it was discovered also that the first impression of an interview could be deceptive, as the real value of certain statements may only become apparent during the stage of analysis. The only major advantage of note-taking the author sees is saving of labour and time. Yet, the costs are high. The value of what is potentially lost appears far greater than the benefits gained.

All interviews recorded were transcribed. Transcriptions followed pragmatic rules. Neither was it necessary to transcribe aspects unrelated to the research questions, nor was there a need to include linguistic annotations. Rather oral speech was transferred into written style. Only in few cases the audio quality was that bad that there was a danger of mishearing or misinterpretation, in these cases the respective sentences were left out. The transcripts, each between three and ten pages long, were then used as the basis for coding according to predefined categories, which related to the various variables and their operationalisation (see Chapters 3.4 to 3.7). Subsequently, the data collected was analysed in-depth and verified when necessary. The author translated all direct quotes originally not in English that would be included to the study.

To complement and deepen insights gained from formal expert interviews, focus group discussions (FGDs) with tax officials and business representatives were conducted. Methodological literature emphasises participant interaction as the main advantage of FGDs to individual interviews (Morgan 1997; Barbour/Kitzinger 1999). As FGD participants explore topics together, the general idea is that the conversation becomes more natural and informal, thus the method is able to elicit attitudes, concerns, ideas, and opinions, which would otherwise be hidden to the researcher. The information

obtained from FGDs is therefore believed to be richer and more complete than the information obtainable from individual interviews. More critical authors however warn that FGDs might also have disadvantages, for example it can be precisely the group dynamics, which might censor individuals' responses (Stewart et al. <sup>2</sup>2007: 19-36).

For the purpose of this study the author developed two different topic guides, one for the FGDs with tax officials and one for the FGDs with business representatives. These addressed issues on the perception of the tax administration in general and the process of reforms. Following common guidelines for conducting FGDs, local researchers were contracted to logistically organise and moderate the discussions. The goal was to have between six and ten participants in each group to discuss the topics provided by the topic guide. The author participated as observer only. FGDs were conducted at the weekends, participants invited to restaurants and hotels where food and drinks were provided, and a representation allowance for each participant was paid. As Table 3.3 shows, it was difficult to motivate individuals to participate. In both countries the participation rate was low; half the discussions fell below target.

TABLE 3.3: *Focus Group Discussions: Number of Participants*

Focus Group Discussions	Indonesia	Philippines
Tax Officials	6	3
Business Representatives	3	6

Source: Author's compilation.

Similar to interviewees, the personal identity of FGD participants in relation to their statements is not disclosed. FGDs were conducted in Bahasa Indonesia in Indonesia and Tagalog in the Philippines. Each discussion, lasting up to three hours, was recorded and written notes on the proceedings were taken. Later literal transcripts were produced and the Tagalog versions translated into English by a local research assistant. These transcripts were to serve the author as the basis for content analysis.

Unfortunately, both in Indonesia and the Philippines, all FGDs failed to live up to expectations. Dialogues, let alone discussions, did not develop. While the moderators, as instructed by the author, encouraged participants to interact, refrained from interfering, and waited patiently, what was supposed to be a discussion turned out to be rather one-on-one interviews with an audience. Responses further were shallow. Given the costs and expenses involved with focus group discussions both for the participants and the researchers, and the quality of the outcome, the author comes to the conclusion that the method did not provide any benefit added. In hindsight, it would have been better to do without focus group discussions and rather spend the time and effort on additional one-on-one interviews. The method might make sense to get an overview of topics in the initial stages of research, yet seems less useful for complementing research, let alone further probing. An explanation, probably applicable also to the low participation rate, might be rooted in the cultural background of both countries, where conformity and conflict avoidance are highly valued. To publicly hold a personal

opinion that might be diverging and contestable requires individuals to overcome a barrier significantly higher than in intimate two-person relations.<sup>25</sup>

Field research was further used to collect grey literature and a large body of primary written sources. Requests for documents, such as the annual reports from the finance ministries, tax authorities, civil service agencies, state audit boards, and anti-corruption agencies, and pertaining statistical data generally had to be submitted in writing and often required several follow-ups. In many cases it took quite long until the documents could be collected, sometimes it was impossible to obtain data asked for.<sup>26</sup> This was not necessarily because the government agencies were unwilling to provide it, but also because they themselves did not have access to reliable data. Annual national budgets, budget speeches, state of the nation addresses, relevant legislation, journal articles, and newspaper articles complement the corpus. In the Philippines complete sets of various documents and reports could be collected for the time frame 1986 to 2011, in Indonesia in many cases only from 2000 until 2011.

To answer the study's questions, the analysis of a wide array of relevant variables is necessary. The following sub-chapters, divided into four arenas, the national context of reform, administrative conditions for reform, process of reform, and indicative outcomes of reform, give a detailed description of the set of independent (explanatory) and dependent (outcome) variables identified for this study. The main propositions underpinning the selection of variables and indicators are outlined. The variables and indicators identified are not exclusive, but regarded as sufficiently diverse to allow for in-depth analysis and comparison.

### 3.4 National Context of Reform

Tax administration is embedded within a broader environment. "It imposes demands on it, places limits on what it can or cannot do and creates opportunities that the organization can exploit" (Gill 2000: 12). Contextual factors thus are treated as independent variables. Neopatrimonial profile, public administration concept, and socio-economic development are relevant contextual factors in regard of taxation and tax reforms. The following sections explain why and describe their operationalisation.

#### 3.4.1 Neopatrimonial Profile

As pointed out earlier, variations in the neopatrimonial profile are regarded central in explaining shortcomings and weaknesses in taxation and reform trajectories. To analyse its form and degree in the case studies' political and social relations, the classic three-dimensional definition of neopatrimonialism is adopted: concentration of power,

<sup>25</sup> Also the focus group discussions conducted on education with officials from the education authorities and parents from school children, which the author conducted but which were not included in this study, disappointed. Hence, it is unlikely that it was the topic of taxation which alone can be blamed.

<sup>26</sup> A number of documents finally had to be collected by local research assistants and shipped to Germany after the field research was completed.

systematic clientelism, and particularistic use of state resources (Bratton/van de Walle 1997: 63-68). For analytical reasons, the political and administrative dimensions of the concept are separated.

To go beyond neopatrimonialism's heuristic value and use it as an analytical tool for empirical research the identification of meaningful and measurable indicators is required. This has been notoriously difficult. So far, few explicit attempts have been made (Snyder 1992; Bratton/van de Walle 1997; Budd 2004; von Soest 2009) and those that have been made remained controversial (see Erdmann/Engel 2007; Pitcher et al. 2009; Erdmann 2012). With the difficulty in observing and measuring neopatrimonial practises, a challenge has been to find indicators which are closely correlated to the phenomenon analysed and are likely to really capture what they are to capture.

The neopatrimonialism indicators used for this study, build upon its predecessors who focused on Sub-Saharan African countries and methodological considerations developed within the research project "The Persistence and Change of Neopatrimonialism in various Non-OECD Regions" at the GIGA German Institute of Global and Area Studies, yet they are adapted to the Southeast Asian context and in a number of aspects specified further.

In regard of the 'concentration of power' dimension, Bratton/van de Walle (1997: 63) treated the "systematic concentration of power" as virtually equal with "big man rule", highly personalised rule exercised over a long period of time, while von Soest (2009: 56f) "draws an 'and-connection' between a long tenure of Presidents and a short tenure of key government members", investigating the tenure of the president in relation to the tenure of the vice-president and four cabinet ministers. This study argues that these indicators are good starting points, yet first need to be extended to capture the Southeast Asian reality and second need to be more specified to increase the likelihood of capturing what they intend to capture, that is neopatrimonial rule. Therefore, it analyses elite's concentration of power both in the national executive and legislative. As to the president's power, the presidents' average tenure in relation to the average tenure of ten key ministers before and after democratisation is calculated. Moreover, the relationship between the president and the legislature and its development over time is analysed. As to power concentration in the legislature, the composition of the legislature is analysed. Of particular interest are rotation patterns, dynastic backgrounds, business involvement and the personal wealth of legislative members. Polity IV's Executive Constraints Indicator (see Marshall/Jagers 2009), the World Bank's Database of Political Institutions Indicator Checks (see Keefer 2007), and Henisz's (2002) Political Constraints Index are further considered to gain a more objective picture. The way power is exercised is regarded of utmost importance to assess whether observed power concentration is indeed neopatrimonial.

This aspect is further elaborated and analysed within the second dimension 'systematic clientelism'. Bratton/van de Walle (1997: 65) pointed to the award of personal favours by the big man, which can take the form of public sector positions and public resources, to the political elite in order to secure personal loyalty. This study rather follows

Piattoni (2001: 2) who perceived clientelism and patronage as strategies “for the acquisition, maintenance, and aggrandizement of political power, on the part of the patrons, and strategies for the protection and promotion of their interests, on the part of the clients”. In this sense, it is an exchange relation between patrons and clients, whereby systematic clientelism is regarded as an “over inflated form of patronage” (Piattoni 2001: 6). Von Soest (2009: 57) suggested measuring this dimension, he calls “provision of personal favours”, by analysing “the size and the composition of the ministerial cabinet”. Again, this study argues, that the analysis of this indicator is useful, yet the indicator alone falls short to capture neopatrimonial rule. Therefore, in addition to analysing cabinet size over time, its composition and the logics behind the distribution of ministerial positions are assessed. The study also looks into the prevalence of presidential advisors, assistants, consultants and special coordinators, arguing that the ministerial cabinet does not necessarily have to be the focal point of systematic clientelism. The constitutionality of appointments is further considered.

The third dimension ‘particularistic use of state resources’ also touches the aspect of how powers are used. According to Bratton/van de Walle (1997: 66) “the use of state resources for political legitimization” implies that neopatrimonial leaders make “little distinction between the public and private coffers, routinely and extensively dipping into the state treasury for their own political needs”. In this sense, there is a strong association with corruption and other rent-seeking behaviour. Von Soest (2009: 57f) used “the misappropriation of public funds, assessed for instance through the existence of special funds over which only the big man has discretion, as an indicator”, further he referred to Transparency International’s ‘Corruption Perceptions Index’ (see Graf Lambsdorff 2005) and the World Bank’s Worldwide Governance Indicators ‘Control of Corruption’ aggregate indicator (see Kaufmann et al. 1999). This study follows, by analysing the perceived degree of corruption, defined as the misuse of public positions for private gain (Klitgaard 1988), the existence of off-budget funds, and the existence of discretionary funds. As regards the latter, it is of particular interest to find out what logic the release and the direction of funds follows.

The analysis of these three dimensions together is expected to provide a reasonable picture of the case studies’ neopatrimonial profiles to later assess its proposed impact on taxation and tax administration reforms.

### **3.4.2 Public Administration Concept**

The public administration concept is defined to encompass the bureaucracy’s structural, organisational and procedural features. Within these features path dependence has been widely observed. In many former colonies, the colonial regime’s influence on the set-up and practises of public administrations has remained visible long after independence (La Porta et al. 1999; Acemoglu et al. 2001). A perpetuation, but also some differentiation in particular during authoritarian and later democratic periods, is to be expected. Therefore, the emergence and development of the civil service in the case studies is

traced and the potential impact of civil service rules, traditions and norms that have developed on administrative performance and reform capability assessed.

Moreover, as the tax administrations under review remained offices under the national Ministry/Department of Finance and tax officials are civil servants general civil service rules apply and are likely to remain binding. They constitute both opportunities and boundaries for the administration's functioning and officials' room for manoeuvring. Modernisation and reforms may be impeded when reform ideas clash with higher ranking regulations and traditions. The systematic analysis of general structures and mechanisms in place thus lays the grounds for later informed assessment of the tax administration. Special attention is given to human resource issues. The criteria for hiring and appointment, remuneration and management relations are explored. Divergences from Weber's (1978 [1922]) ideal-type model of "modern bureaucracy"; in particular the politicization of and economic elite interference in the civil service, are of special interest.<sup>27</sup>

### 3.4.3 Socio-Economic Development

The socio-economic structure of a state relates to its effective need to tax as well as its realistic potential to collect taxes (Musgrave 1969; Chelliah 1971; Tanzi 1992; Burgess/Stern 1993). Largely outside of the tax administration's control, but impacting on its revenue performance, knowledge of these background conditions therefore is crucial to interpret the development of tax collections and the likely influence of tax administration reforms. The study thus analyses the development of a range of macroeconomic indicators relevant to taxation over time.

First, it analyses the composition of government revenue, disaggregated into non-tax revenues, that is in particular primary commodity export rents; grants, that is in particular development aid; and tax revenues. This serves to establish government's effective need to collect domestic taxes. Based on the literature, it is assumed that a large share of non-tax revenues and foreign loans and grants reduce the need to collect (Moore 1998; Bornhorst et al. 2009; Knack 2009).

The potential to collect tax revenues is derived by the analysis of the country's economic development, proxied via its per capita income and annual GDP growth; its fiscal balance; and the distribution of wealth, proxied via the human development indicator, the GINI ratio, and the poverty incidence. Further, the size of the country's work and labour force, as well as the size of its informal sector and informal employment are considered. Here, it is assumed that economic growth is favourable to tax collections (Tanzi 1987), crisis, such as a fiscal deficit, increases the pressure on the government to raise revenue collections (Alesina/ Drazen 1991), and that widespread poverty and a large informal sector (Alm et al. 2004) present unfavourable conditions

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<sup>27</sup> The core virtues of a classic Weberian bureaucracy include impersonal procedures, technical competence, distance from societal interests and hierarchical accountability (Weber 1978 [1922]: 126-130). An extractive bureaucratic apparatus requires these virtues to a greater extent than a redistributive apparatus (Moore 1998: 106).



for tax collection as either the fiscal potential is lacking or it is hard to trace and verify taxable income (Bird et al. 2004; Gupta 2007; Profeta/Scabrossetti 2010).

### **3.5 Administrative Conditions for Reform**

The analysis of the administrative conditions for reform constitutes a central part of the study. This serves to establish a good understanding of the status quo of tax administrations prior to the reforms discussed. Evidence on what accounts for shortcomings and weaknesses in taxation is provided. So far, no widely accepted analytical framework for assessing tax administrations exists. A number of approaches for comprehensively analysing tax systems and assessing tax administration capacity have however been developed in the last decades (for example Tanzi/Pellechio 1995; Silvani/Baer 1997; Gill 2000, 2003; OECD 2004; Gallagher 2005; von Soest 2007; Bird/Zolt 2008; Crandall 2011; Vázquez-Caro/Bird 2011). While all of these focus on different aspects, tend to use slightly different definitions and organise their indicators into different category clusters, they share that they examine the key dimensions of the tax administration. Keeping a Weberian perspective, variables and indicators chosen are inspired by a critical engagement with these recent approaches and their fit into the study. Yet, the study goes beyond measuring performance against international best practise and takes the stakeholders' perceptions of what constitute real problems seriously. This is in line with recent international thinking on institutional change in developing countries (cf. e.g. Andrews 2013).

The following sections describe the independent variables: evolution of the tax administration, human resource management, business operations, and administrative accountability, and their operationalisation as applied in this study.

#### **3.5.1 Evolution of the Tax Administration**

Starting from pre-colonial times when first evidence of tax collections were traced, the analysis follows the genesis of the tax authorities through colonial and post-colonial times, ending with a description of the state of the tax administration in the early 2000s. The initial set-up of the tax authorities and their subsequent major modernisation and reform episodes, both in regard of tax policies and of tax administration, are discussed. The underlying assumptions are first that the outreach and organisation of the tax authority has a direct influence on its capability to collect. And second that the way taxes were collected, following the logic of path dependence, has shaped the attitude of both officials and citizens towards taxation. Similarly past reform experiences may have an influence on current and future reforms. By describing the tax authorities' set-up, further the formal organisational framework is introduced.

#### **3.5.2 Human Resource Management**

Qualified, competent, and empowered staff is widely regarded essential for organisational success. For the tax administration it is as an important prerequisite as

well (Mikesell 1974; Schlemenson 1992; Bird/Zolt 2008). Hence, this study looks closely at human resource management issues.

First, statistical information is presented and discussed. The absolute and relative numbers of tax officials give a first indication on the importance the government has placed on raising revenues, the likely outreach of the tax authority, as well as the workload of tax officials. Tax officials' competence and their distribution among qualification levels and type of positions, e.g. clerical and technical, provide hints as to the emphasis that is placed on certain functions of the tax administration. A lack of audit, legal, and IT personnel, along with a surplus of clerical staff for example suggest a weak enforcement capacity of the tax administration. International benchmarks are used as comparators for the calculated quantitative indicators.

Second, the study investigates whether the tax authorities' human resource management decisions follow the merit principle or rather the neopatrimonial logic. What is the decisive factor for recruitment, qualifications or personal contacts? Are tax officials trained systematically and what is the content of these trainings? Which factors decide on placements and promotions? In how far are careers predictable? What is the organisational culture, defined as the set of values, beliefs, and norms the majority of staff shares, and what role does it play? A positive correlation of meritocracy and curbed corruption was found in previous studies (Rauch/Evans 2000); effects of career stability or competitive salaries on the other hand so far could not be established. Elite capture of the bureaucracy, in particular in the form of political interference, stands in the focus of analysis.

### **3.5.3 Business Operations**

The way the tax administration works in its day-to-day operations is mainly prescribed through tax legislation, formal organisational rules, and informal practises. This study aims to take a comprehensive view by systematically analysing the main characteristics of tax legislation and the tax administration's core business processes individually and as they relate to each other. Tax administration's core business processes are registration, assessment, audit, payment, enforcement, and reporting.

Tax legislation can be an issue in at least three regards. First, regular comprehensive tax exemptions, concessions, incentives and benefits reduce the amount of potential taxes the tax authority can collect and send taxpayers a signal on future enforcement activities. In the mid- to long-term this may lead to an overall net-deficit (Wells et al. 2001; Baer/Le Borgne 2008). Second, complex and frequently changing tax legislation can pose high compliance costs in meeting tax obligations in addition to actual tax payments on the taxpayers, and high administrative costs for enforcement and collection on the tax officials (Evans 2003; Bird/Zolt 2005: 936f). Third, overly complicated and arbitrary tax legislation gives wide room for interpretation, which might be used and abused by both tax officials and taxpayers for tax avoidance, legal ways to reduce taxes, as well as tax evasion, an illegal activity. Both parties could collude, the tax official could extort the taxpayer, in particular if he has collection goals to meet, conversely the

taxpayer could argue that certain rules are applicable or do not apply to him. Tax legislation in this regard influences how core business processes can be shaped.

Tax administration is “first and foremost an organization dealing with information .... [Where a]ny offence which reduces the information available to the administration, ... has an implicit value in terms of expected revenue lost” (Bird 2004: 143). Thus of particular interest is, how the tax authority collects the necessary information on taxpayers and the way the collected data are processed. This includes aspects of verification, utilization, dissemination, storage, and retrieval.

Attention is paid on the degree of manual, face-to-face work as opposed to the degree of information and communication technology used. Detailed record keeping and systematic tax investigation activities for example are expected to reduce discretion and enhance compliance. The relationship and interaction between tax officials and taxpayers in particular during assessment, audit and payment, as well as the relationship between tax officials themselves are studied. By studying core business processes, also various *modi operandi* for tax evasion, as they occur in the cases studied are described. Again, the aspect of potential elite interference receives special attention.

### 3.5.4 Administrative Accountability

Administrative accountability refers to the perceived integrity of tax officials and the related tax compliance of taxpayers. It also alludes to the established formal accountability institutions and mechanisms mandated to check the tax administration.

Taxpayers’ voluntary compliance to pay taxes tends to be higher when the tax authority is perceived to have integrity (Levi 1988; Tilly 1990).<sup>28</sup> The study thus seeks to explore in how far the risk areas outlined in the chapter on business operations present risk areas only or have become real opportunities (mis)used. As reliable data on the extent of corrupt activities, which in most cases involve both taxpayers and tax officials, are not available, this study uses perception surveys as proxies. Both local and international surveys on the perceived prevalence and extend of corruption in the tax administration as such and in relation to other government offices are explored. Further, informed local expert opinions are considered.

Accountability mechanisms serve to check that public office conducts its tasks in a transparent manner, according to the mandate and the relevant norms and rules applicable. Moreover, they are to ensure that citizens’ rights are not improperly infringed upon. It is widely accepted that public officials should be answerable to all their decisions and actions. In the absence of functioning accountability mechanisms the misuse of official powers for private gain tends to increase. To hold the tax authority and its officials accountable, prevent abuse and ensure that corrective measures are taken if necessary, both internal and external control mechanisms have been established

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<sup>28</sup> Of importance is also the citizens’ belief that the state spends taxes reasonably, including the perception that they get something in return. An examination of the expenditure side however goes beyond the scope of this study. Hence it needs to be assumed that citizens in both case studies are equally unsatisfied, thus the effect from the expenditure side can be neglected in this analysis.

in most countries of the world (Schedler 1999). Internal mechanisms can include specialised offices, but also simply regular performance audits. External mechanisms may include audit agencies and ombudsman offices. This study looks into the accountability mechanisms in place in the case studies; it tries to find out how they work and aims to establish how effective they are.

The enforceability of tax obligations includes that taxpayers are given a chance to complain and seek redress when they feel that the tax authority treated them improperly. To do that, they need information about the standard rules and regulations, and have an official body to turn to. Specialised tax courts take up this function in most countries. They are tasked to handle and adjudicate tax-related disputes as neutral intermediaries. Therefore, the availability and quality of taxpayer information are researched. Moreover, the set-up and the functionality of the tax courts are explored.

### **3.6 Process of Reform**

As pointed out earlier, it is reasonable to believe that institutions provide both the framework and the space for modernisation and reform, yet that they do not determine what can be done and how these measures develop. Actors can shape as well as hinder reform processes within the structural opportunities and constraints they face. The following sections elaborate on this crucial aspect. They describe the independent variables: domestic actor constellations, donor influence, change management, and reform dimensions, and their operationalisation as applied in the study.

#### **3.6.1 Domestic Actor Constellations**

Tax administration reforms aimed at reaching a more effective and efficient, equitable and impartial tax system have a direct influence on numerous organisations and individuals within and outside the tax authority. As change inevitably creates winners and losers, we can expect to deal with a large set of interests and strategic bargaining between these interests. Understanding who these interests are, which positions they advocate, what relative strength they have and how they interact is of high relevance.

Previous reform experiences worldwide have shown that “reform programs sometimes falter because they are politically infeasible” (Nunberg et al. 2010: 6), not because of insufficient technical knowledge and reform capacity. There is wide agreement that “... tax reform is always and everywhere an exercise in practical politics” (Bird 2003: 27). It is the balancing of vested interests that stands at its core. “Particularly difficult to deal with are reforms that face powerful losers, who are opposed to change and have significant resources to mobilize, and weak winners, who benefit but have little capacity to support change” (Brinkerhoff 2000: 246). Thus, it comes of little surprise that both practitioners and scholars of tax reforms have come to agree that domestic ownership, effective political will to design, initiate and pursue drastic measures, and strong leadership are decisive factors for sustained modernisation and reform success (Andrews et al. 2010). Brinkerhoff (2000: 242) defined political will as “the commitment of actors to undertake actions to achieve a set of objectives – ... – and to sustain the costs of those

actions over time". Bird (2003: 21f), summarizing past experience and scholarship, pointed out that it needs a champion, a catalytic person, consolidators, and the strong support of these individuals by the chief executive. Reforms are a team sport.

Those with an interest in and affected by the reform are defined as the stakeholders of reform. The following relevant domestic stakeholders were identified: the president; the executive's economic team which includes the minister of finance, the coordinating minister for economics in Indonesia, the undersecretary for revenues in the Philippines, and the head of the tax authority; tax officials; politicians; business representing taxpayers; academics; civil society and the media. The latter two were chosen mainly for their potential watchdog and agenda-setting roles.

Actors decide on their interests and actions in relation to environmental factors, hence interests and actions are regarded as dynamic, shifting or altering in intensity as changing circumstances are faced. Therefore, a comprehensive view, considering the constellations and interactions between the various stakeholder groups, is necessary. Patrimonial and clientelist relations are likely to come into force. It follows that insights gained from the analysis of the countries' neopatrimonial profiles come into play.

Interests and will are difficult to measure. Analysing official statements and documents alone falls short in digging deep enough. As much as these may express real objectives, they may as well be mere rhetorical statements hiding genuine intentions. It may rather be concrete actions that point to the preferred directions. It is important to keep in mind that groups are not unified bodies of actors; diverging interests and opinion may exist within each group. The expressed positions, particular actions, and roles of the various stakeholder groups are thus to be analysed. Where divergences in opinion are pronounced, the different interests shall be explored; in other cases those perceived dominant for the reform path shall be scrutinised.

Due to the hierarchical structure of public administration in the case studies, the analysis places particular attention to the analysis of the economic teams. It is expected that personnel decisions in these positions are a focal point of contestation between the most powerful stakeholders. Of interest is: who is appointed and why, what the appointees' motivations and approaches are, and how secure their tenure is. Are they technocrats who have been chosen based on their competences and qualifications, or are they individuals chosen due to external pressures? Frequent rotation of key personnel is interpreted as a sign of weak political will, as it impedes upon the reform process. Similarly, it is an indicator of strong vested interests opposed to reforms.

### **3.6.2 Donor Influence**

International bilateral and multilateral donors' influence on developing countries is inconclusive: While proponents claim that donors are important entities in assisting developing countries to reach higher development levels, critics claim that donors are more driven by self-interest, motivated to exert influence, as well as to secure prolonged engagement through a growing loan portfolio (Araral 2009). Easterly (2002) and others further criticise donor agencies as more worried in the disbursement of funds than in the

attainment of objectives. Conversely, recipient countries' engagement with international donors by some people is regarded as an honest endeavour to get assistance in eradicating poverty and by others as a choice for a comfortable way of financing state expenses. Reform processes, so it is believed, are pushed or delayed accordingly.

An insight into motivations and interests pursued hence, in relation to the earlier discussions of ownership and leadership, can be used as indicators for likely reform success. Problem consciousness and solutions development from the inside, in consultation and cooperation with outside advisers, as opposed to actions as mere reactions to the outside, can reasonably be regarded more promising. The study therefore describes which donors are engaged, where they engage and how they engage.

In case a large number of donors are found to be involved, a further issue that needs attention is the looming danger of donor fragmentation. Many donors do not necessarily imply many resources and many ideas which could be helpful in reaching goals, but could also mean diminished efficiency of development projects, due to policy incoherence, duplication, and donor competition for the same limited domestic resources, and an unnecessary administrative burden for the implementing agencies (McCormick/Hubert 2011; Schulpen et al. 2011). The relation of donors and their coordination efforts thus are explored.

### **3.6.3 Change Management**

Reform does not come by instruction or order. It needs to be managed. Changes to the formal framework do not suffice for meaningful reforms; also attitudes and mind-sets of tax officials, taxpayers and the general public need to be changed. In particular when a tax administration is regarded deeply corrupt and large numbers of taxpayers are perceived to engage in tax evasion, reformers are challenged to restore integrity, create a positive attitude towards taxation and encourage mutual trust. Reform-oriented individuals need to be strengthened, resisters need to be contained and those indifferent need to be convinced that it is worth to be engaged.

Hence, this study explores how the tax administration reforms are managed. It distinguishes between two change management arenas, the internal, with tax officials at the core, and the external, with taxpayers and the general public at the core.

In regard of internal change management it asks: Who plans the reforms? Does a dedicated transformation unit exist? How are the staff members to manage reform initiatives chosen? How the reform message is transmitted and communicated from headquarters to the most remote tax offices? What kind of incentives for compliance and more responsive behaviour, and what kind of sanctions for misconduct and ignorance have been introduced? In how far are these measures likely to be effective in leading to real acceptance and buy-in, as opposed to mere formal commitments, and finally to a different outcome in risks-benefits calculations? How coherent and consistent are the management strategies?

External change management targets the citizens. To increase tax revenues, citizens need to be convinced of the value of taxation and convinced that tax evasion is not an

option. Taxpayer education, both about taxation in general and the undergoing tax reforms in particular, is the strategy of choice in most countries, as it is expected to be more effective in the long run than sheer enforcement. Where education finds its limits though, there is wide agreement that resolute enforcement needs to complement the change management strategy. Without taxpayer education and the certainty that tax payments in last resort will be enforced the voluntary compliance of taxpayers is likely to remain low. The study therefore engages with the strategies of reformers directed towards the general public and tries to establish in how far they are favourable in light of attaining reform goals.

#### **3.6.4 Reform Dimensions**

The term reform requires that something that is regarded inappropriate to meet current demands, norms or standards, be targeted for innovation or amendment to be transformed into something that comes closer in meeting the expectations. Tax authorities committing to reform are encouraged to make up their minds of what it is that needs to be reformed and which of these ideas they wish to work on. What gets to the implementation stage presents the scope of reform. This negotiated space has significant impact on the overall success of the reform endeavour.

The study therefore seeks to establish how the reforms in the two case studies have proceeded. What has been decided on and what did get to the implementation stage? What logic did the decisions follow? In how far has there been coherence and consistency in the various projects introduced? Has there been a bigger picture wherein the different parts of the reform programme do fit well together?

The analysis sketches developments in broad outlines, yet where necessary to back up or illustrate an argument made it engages in the microanalysis of specific events and cases also. While being specific it is reasonable to believe that these cases can be generalised to the broader trends at large.

### **3.7 Indicative Outcomes of Reform**

Reforms have ultimate goals. In tax administration reforms these are to increase tax collections and create a positive image of taxation and the tax administration. Reform success, the dependent variable of this study, thus is measured against developments in these areas. Revenue performance and taxpayers' attitudes and opinions towards the tax administrations are defined as reform outcomes. Visible positive trends in these areas are believed to be positively correlated with improving tax administration thus may adequately be used as measurement proxies.<sup>29</sup> The data present trends; they are not able to predict sustainability. Hence, this study cannot conclude with finality how successful

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<sup>29</sup> Increased tax collections may also be the result of increased levels of coercion and predation. As the relations between tax officials and taxpayers however are analysed in detail for the period under review, the study is able to incorporate this argument into the assessment. With no increase in these areas found, higher collections are most likely to be related to tax reforms or macroeconomic developments.

reforms have been. It is however claimed that enough evidence exists to judge, in relation to the insights gained previously, which direction they have taken.

### 3.7.1 Revenue Performance

Revenue performance data are comparatively objective indicators. Yet, due to weaknesses and shortcomings in tax revenue data and major difficulties in cross-country comparison of such data (see Chapter 1.3), it is not absolute figures that stand in the focus of analysis, but relative developments. It is the change of indicator values over time in each case study, which is regarded as meaningful and interpretable.

The most widely used indicator to judge a country's revenue performance is the tax ratio, i.e. actual revenues as a percentage of GDP. On its own, this measure however is insufficient to assess developments (Cantens et al. 2013). As Casanegra de Jantscher and Bird (1992: 1) pointed out "The 'best' tax administration is not simply one that collects the most revenue. *How* that revenue is raised – ... – may be equally important". Therefore, a set of different tax ratio indicators is used and tax effort measures, comparing actual with potential numbers, are further considered to complement analysis.

First, the development of registered taxpayers is analysed. In relation to the tax potential it indicates in how far the tax authority has managed to tap the country's fiscal opportunities. To balance interpretations, the identities of newly registered taxpayers need consideration.

Second, the total of domestic revenues collected by the tax authorities, and the collections from major tax types are put to analysis. The development of direct taxes, such as income tax, is of particular interest, as these in relation to indirect taxes, such as value-added tax, are more difficult to impose. The reason is that taxpayers directly feel these taxes. Also, an increase in direct taxes tends to affect more high income individuals, while an increase in indirect taxes tends to affect more the poor. Hence, an increase in direct taxes is likely to indicate more efficient tax mobilisation and collections. As the increase or decline in collections however cannot be exclusively attributed to the performance of the tax authority, the study puts observed developments also in relation with developments outside the tax authority, such as macroeconomic developments and tax policy reforms. It seeks to establish what most likely has caused certain increases or declines to deduce the likely impact of tax administration reforms.

Third, the annual income tax return compliance ratio and the cost of collection ratio of the tax administration are calculated. These could provide further hints in how far there might have been an increase in efficiency and effectiveness of the tax administration.

### 3.7.2 Taxpayers Attitude and Opinion

Attitude and opinion are subjective data, yet they are important as they indicate how the tax administration is perceived. How it is perceived on the other hand impacts the voluntary compliance therefore the tax authority's actual tax collections.

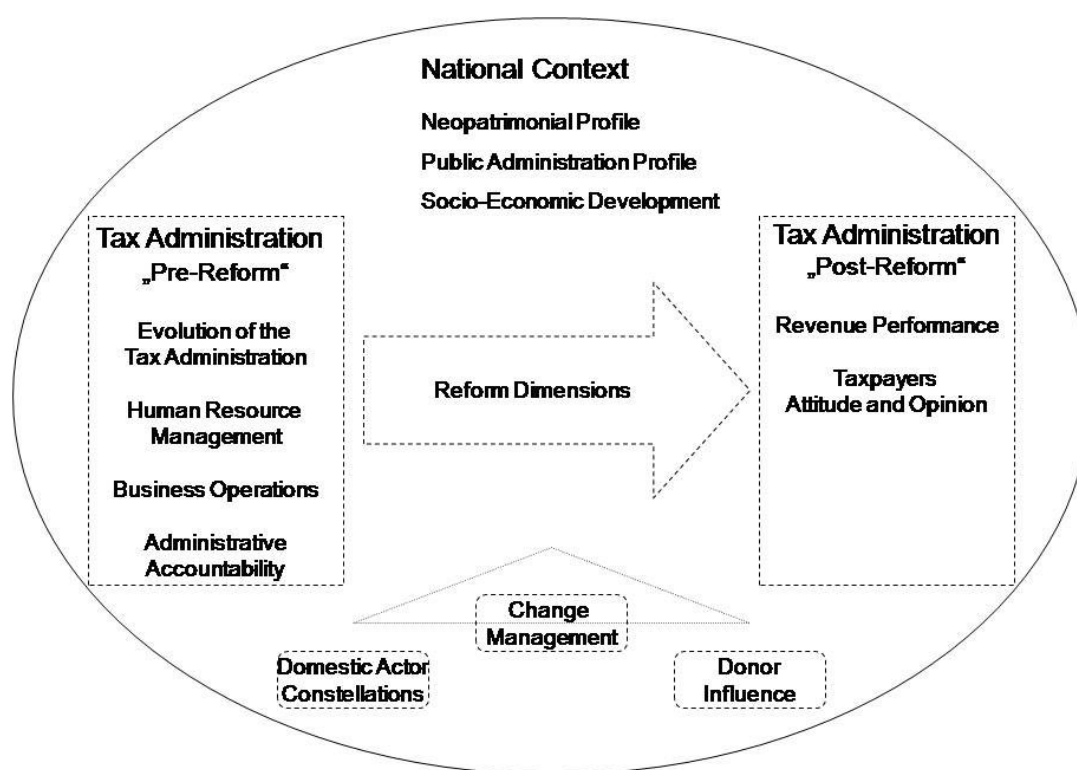


The study uses data from public opinion surveys and interviews. Of particular interest is whether a change of opinions, before reforms and several years after the reforms were started, has occurred. How is the tax authority perceived to carry out its work? The bigger picture is presented; where available also perceptions on specific reform issues are included.

### 3.8 Summary

The study applies a small-N qualitative research approach with quantitative elements. Indonesia and the Philippines were selected as case studies following the most-similar systems design strategy. The study is informed by secondary sources, yet relies heavily on information collected from 90 formal expert interviews and written primary sources. A large set of independent and dependent variables, summarized in Figure 3.1, are analysed to answer the study's questions.

FIGURE 3.1: *The Political Economy of Tax Administration Reforms*



Source: Author's illustration.

After elaborating the underlying conceptual and analytical frameworks, the discussion can now proceed to the actual case study analyses. For structured comparison, the case studies on Indonesia's Directorate General of Taxes and on the Philippines' Bureau of Internal Revenue follow an identical analytical grid.

## **4 Case Study: Indonesia's Directorate General of Taxes**

The Republic of Indonesia is one of the world's largest countries. Its 17,500 islands stretch 5,120 km from east to west, and 2,000 km from north to south. They cover a land area of 1.9 million km<sup>2</sup> and are populated by 238 million inhabitants. The country consists of five major islands: Java, Sumatra, Sulawesi, Kalimantan, and Irian Jaya. Its capital city is Jakarta, located on the island of Java. By 2010, the country consisted of 33 provinces, which further had been subdivided into 502 districts and cities, 6,543 sub-districts, and 75,244 villages. Population, wealth and infrastructure are not distributed equally across the country. Java, the most densely populated island, comprising 57% of the total population, is more advanced than all other islands. It is the center of national economic activities. The provinces DKI Jakarta, East Java and West Java contribute about 46% of total national economic activity. East Kalimantan and Riau provinces, primarily from the oil and gas sector, contribute another 12%. The rest is contributed by the remaining provinces (Data from Statistics Indonesia). With regard to Indonesia's vast geographical domain implementing change nationwide is a challenge.

### **4.1 Introduction**

Indonesia's Directorate General of Taxes, the DGT, has initiated tax administration reforms in 2002. The case study aims to shed light into the political economy of these reforms. The main goals are to understand why the DGT's tax collection performance for decades has been below expectations, how the reforms proceeded, what impact they had and why they proceeded as they did. The chapter is organized into five main sections: first it describes the national context of reform, second the administrative conditions of reform, third the process of reform, fourth the indicative outcomes of reform, and finally a concluding section synthesises the main findings of the case study.

### **4.2 National Context of Reform**

#### **4.2.1 Neopatrimonial Profile**

Between the mid-1960s and today, Indonesia experienced two distinct regime periods. The authoritarian New Order regime of President Soeharto, which lasted from 1967 until his ouster in 1998, and the following democratic Reformasi Era, which saw peaceful and orderly change of so far four presidents: B.J. Habibie (1998-99), Abdurrahman Wahid (1999-2001), Megawati Sukarnoputri (2001-2004) and Susilo Bambang Yudhoyono (2004-present). During both periods, all three dimensions of the neopatrimonial concept have featured consistently.

### *Concentration of Power*

The New Order regime was characterised by a steadily increasing concentration of power in the hands of the President. While Indonesia's 1945 Constitution assigned political power to the president and two legislative bodies, the People's Consultative Assembly (MPR) and the People's Representative Council (DPR), the overall picture of the regime was that of a dominant executive. Constitutionally, the MPR's assigned functions were to elect the president and the vice-president every five years, amend the constitution, determine the Broad Outlines of State Policy and issue quasi-constitutional decrees. DPR's main assigned functions were to adopt legislation and pass implementation laws for the broad directives of MPR.

In reality, the legislatures had a more symbolic character. During his reign, General Soeharto tightened his control by depoliticizing the Indonesian society, silencing opposition, and carefully controlling and manipulating electoral processes. Election results were predictable: legislatures dominated by parliamentarians of the government's electoral vehicle, Golkar (Party of Functional Groups), and the military. Parliament was the place, "where cronies and time-servers could be rewarded or sidelined, and where a ritualised pretence of democracy could be played out" (Sherlock 2003: 4). The legislatures were powerless, rubber-stamp legislatures, existing to give legitimacy to appointments and decisions already determined by President Soeharto and his inner circle, and not to review and restrict executive actions (Sukma 2003: 245-246; Ziegenhain 2008: 45-77). "Cynics alleged that its members adhered to the principle of '5 D' that is *datang, duduk, diam, dengar, duit*, which means 'come, sit, be quiet, listen, [take the] money'" (Eklöf 2003: 129).

Consequently, Soeharto's re-election by the MPR was certain. Generally no other candidates were proposed and the decision was unanimous. It was more of a ritual than an election, building into "Indonesia's bureaucratized and encapsulated political process regular opportunities to reorganize higher echelons and to take policy steps that encourage an image of a regime leading from a position of reinvigorated popular strength" (Emmerson 1984: 136).

An analysis of cabinet ministers' rotation confirms that Soeharto made regular use of these opportunities. Table 4.1 shows the results of a count of the number of different individuals appointed to head central government departments. These are considered as key ministers for their theoretical potential to challenge the president, and for the departments' significance in rewarding loyal followers. The average length of tenure of all key ministers of 5.5 years corresponds closely with the president's constitutional five years term of office. This figure is relevant in two regards. First, it indicates the relative political stability of the New Order regime. Second, in relation with the average tenure of the president, it indicates the high degree of power in President Soeharto.

TABLE 4.1: *Tenure of Presidents and Key Ministers, Indonesia (1967-2009)*

Office	New Order: Number of incumbents	New Order: Average length of tenure	Reformasi Era: Number of incumbents	Reformasi Era: Average length of tenure
President (ED)	1	32	4	2.8
Minister of Defence	7	4.6	5	2.2
Minister of Education	8	4	4	2.8
Minister of Energy	6	5.3	3	3.7
Minister of Finance	6	5.3	6	1.8
Minister of Foreign Affairs	4	8	3	3.7
Minister of Health	4	8	3	3.7
Minister of Home Affairs	6	5.3	5	2.2
Minister of Justice	5	6.4	7	1.6
Minister of Labour	8	4	6	1.8
Minister of Trade	9	3.6	4	2.8
Average of Key Ministers (CD)		5.5		2.6
Power Concentration Index (ED/CD)		5.9		1.1

<sup>a</sup> Cabinets were included only if 50% or more of the constitutionally defined presidential term had passed by the time of calculation, i.e. 02 January 2012. Therefore cabinets included into the calculation range from the Revised Ampera Cabinet under Acting President Soeharto, serving from October 1967, to the United Indonesia Cabinet under President Yudhoyono, serving until October 2009. In calculating averages, the observed period of New Order resp. Reformasi Era were each divided by the number of incumbents. ED stands for Executive Duration, while CD stands for Cabinet Duration.

*Source:* Author's calculation based on Indonesian cabinets' data from The Jakarta Post.

President Soeharto's successors faced fundamentally different political realities. Since the demise of his highly centralised regime in May 1998, Indonesia's presidents have been confronted with strengthened legislatures and political fragmentation. These effectively curtailed presidential power. The power of economic elites has increased.

Four major constitutional amendments enacted between 1999 and 2002 have transformed the authoritarian political structures into internationally recognised democratic political structures.<sup>30</sup> The military's role was severely curtailed, civil rights reintroduced, political parties and civil society groups founded, and decentralisation pursued.<sup>31</sup> Further in 2004/2005, the direct election of all executive positions, including the president and the vice-president, was introduced. DPR was moved back to the centre stage of political life and was supplemented by a Regional Representatives Council (DPD), while the MPR lost most of its powers (Sherlock 2007, 2010).

As parliaments' roles have changed, so have their compositions. While some parts of the old elites were able to sustain their power base (Hadiz/Robison 2004), increasingly new faces are gaining seats in the country's parliaments. Political dynasties are still comparatively young and sparse (Mietzner 2009a: 6, 10; JP 13.04.2011). By 2009, about 65% of elected lawmakers were new to the DPR, better educated and younger

<sup>30</sup> As of 2010, Indonesia was the only ASEAN country considered an electoral democracy, and the only state in the region considered as "free" (Freedom House 2010).

<sup>31</sup> For detailed discussions of the constitutional amendments see Ellis (2002) and Lindsey (2002).

than their predecessors (Danudjaja 2009). Yet what remains is an overrepresentation of the country's elites. The link between politics and business is strong, as not only charisma but also money politics gained in importance. About 40% of Indonesia's national legislators hold a business, far more compared to the 1999 election outcomes (K 16.02.2010). However, while ethnically Chinese continue to "...dominate private business (for example, only six people on the most recent *Forbes* magazine list of the 40 richest Indonesian are non-Chinese) ... with a few exceptions, ethnic Chinese still do not exercise direct control over the levers of governmental power" (Aspinall 2013: 6). Among Indonesia's richest who simultaneously hold a prominent political function are Jusuf Kalla (Vice-President 2004-2009) and Aburizal Bakrie (among others Golkar Party Chairman, see Chapter 4.4.1) (cf. MT 28.11.2005).

A large number of representatives with a business background has been active in national parliament's Commission XI, which is responsible for the policy areas finances, national development planning, banking and non-bank financial institutions and relates to the Ministry of Finance, the State Ministry of National Development Planning and Bank Indonesia as executive government partner agencies (see data from CETRO and PSHK). Public opinion is strong, that politicians work more for private politico-business interests than for public interests. As regards the relationship between the executive and the legislative, on balance, the president's power following democratisation is strong, yet restrained.

B.J. Habibie, who was Soeharto's longest-serving cabinet minister, was not elected president, but simply followed President Soeharto as his former vice-president. While the Constitution had not yet been amended, he was the first to feel the reinvigorated strength of the legislatures, when the People's Consultative Assembly rejected his presidential accountability report. As a result, Habibie opted not to pursue the presidential candidacy in the 1999 elections, which he had already scheduled, in an effort to acquire legitimacy, during his first week in office.

Indonesia's founding elections were overall free and fair (Suryadinata 2002: 94-96). Of 48 parties contesting in the general elections, 21 parties were able to gain representation in the People's Representative Council. While Megawati Soekarnoputri's Indonesian Democracy Party of Struggle (PDI-P) gained victory in the general elections, after "a series of backroom deals involving promises of cabinet appointments and other perquisites" (Crouch 2010: 52), Abdurrahman Wahid from the National Awakening Party (PKB), which had gained only third place, was elected president in the MPR's general session. Wahid's presidency was similarly short-lived. While he depended on political party support, his leadership style was incoherent, and at times erratic and capricious. By the end of his first year, he had alienated virtually all political parties. Indonesia's legislatures once again showed their reinvigorated strength, and impeached President Wahid on grounds of corruption allegations.

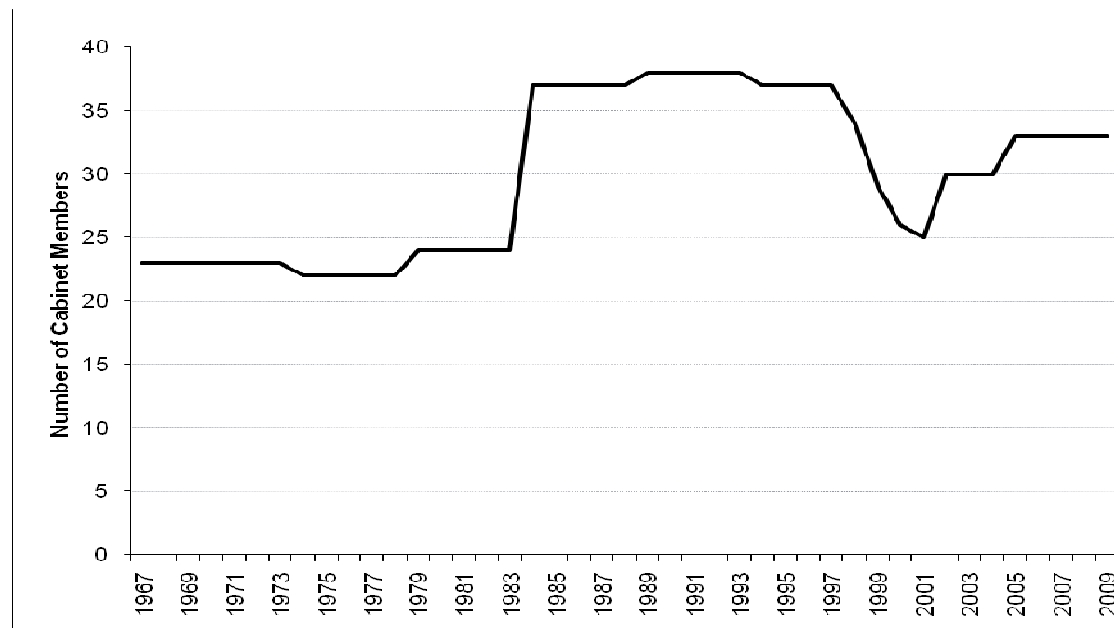
Following his impeachment, Megawati Soekarnoputri, Wahid's vice-president, ascended to power in 2001 (cf. McIntyre 2005). Adopting the strategy of inclusion, Megawati was able to sustain until the end of the term, but she was not able to secure

political backing and public support. In 2004, Megawati sought re-election in the first direct presidential elections, yet was defeated by the reform-minded and widely popular Susilo Bambang Yudhoyono. Yudhoyono is the first post-Soeharto president who not only served a full term but also gained a second term in the 2009 elections. While recognised as the best president post-Soeharto Indonesia has experienced so far, his leadership style increasingly became the subject of critique. Fealy (2011: 334) went as far as to call it a “regal presidency”, with Yudhoyono increasingly reigning, rather than ruling over the country. This may be exaggerated, however observing his presidency one cannot escape the perception of an unassertive, cautious leadership. Numerous episodes indicate that Yudhoyono prefers avoiding open confrontations and bold policy decisions. Instead, he seems eager to appease his supporters and opponents to maintain harmony. Rather than promoting radical reforms, his leadership encourages stability.

The presidents' power has clearly declined. Relatedly, the country's economic elites gained in power. On average, as described in Table 4.1, Reformasi Era presidents have served 2.8 years only, which is less than a legislature period. The key ministers' tenure with 2.6 years differs only slightly from the average tenure of the president's. This indicates that frequent turnover was not a strategy practised by post-Soeharto presidents to secure their positions. Comparing the power concentration index of 5.9 for the New Order period and 1.1 for the Reformasi Era period, we can deduce that presidential power is by now far more restricted than presidential power during authoritarian Indonesia. POLITY IV's Executive Constraints Indicator, the World Bank's Database of Political Institutions (DPI) Indicator Checks, and Henisz's Political Constraints Index substantiate this impression. All three indicators show very low values during the Soeharto years and steep rise following the introduction of democracy, e.g. the DPI indicator Checks counts only one veto-player for the period 1975-1999, two from 2000 to 2003, and five veto-players since 2004.

### *Systematic Clientelism*

Patronage distribution formed the backbone of Soeharto's New Order regime. When President Soeharto first assumed power his political base was weak. To strengthen his position, Soeharto created personal loyalties, rewarded supporters and bought off potential opponents by distributing public sector positions and public resources (Crouch 1979). Figure 4.1 describes the growth of the ministerial cabinet between 1967 and 2009.

FIGURE 4.1: *Size of Cabinet, Indonesia (1967-2009)*

<sup>a</sup> The size of the cabinet varies significantly between different sources. However, the general development trend is comparable. Thus, the described trend is more accurate than the actual numbers. Following Indonesia's National Development Planning Body (Bappenas 2009), the cabinet size depicted includes coordinating ministers, ministers, state ministers and junior ministers.

Source: Author's illustration based on Bappenas (2009).

Cabinet size during the New Order regime ranged between 22 and 38 cabinet ministers. Even considering Indonesia's large population of already more than 150 million in the late 1970s and its vast landmass, which requires different administrative approaches than smaller countries, the size of Indonesia's ministerial cabinets were bloated.<sup>32</sup> The cabinet structure has changed several times. Ministerial competences have never been clear-cut, nor has the functional necessity of various ministries been proven (Interview: Politician). Therefore, it seems reasonable to suppose that patrimonial considerations, rather than considerations of competence and meritocracy, have guided the selection of cabinet ministers.

Cabinet minister positions were divided into those in "wet" and "dry" departments, according to inherent possibilities for making use of the offices for private ends. "The most lucrative (...) are those offices with the power to allocate drilling leases, mining leases, forestry concessions, import and export licenses, government contracts for construction and supply, and state bank credit" (Robison 1990: 14).<sup>33</sup> The distribution of cabinet positions, however, was not solely based on patronage considerations. While

<sup>32</sup> Internationally, an average size of 15 to 25 cabinet ministers is regarded sensible.

<sup>33</sup> Similarly lucrative were positions in state-owned corporations (McLeod 2000). Pertamina, the national state oil corporation, for example, served as a major income source for the New Order regime (Mackie 1970; Seda 2005).

it was certainly true that those in coordinating positions were the “essence of hard working, unquestioning loyalty, men who owed their careers to his favour” (Elson 2001: 226), at least during the early period of his regime, Soeharto also included technocrats in his cabinets. To bring Indonesia's disastrous economic situation under control and with the intention of fostering national development based on the vision of stability, growth and equity, Soeharto increased technocratic influence during that period, peaking at 70% of cabinet ministers in the early 1970s. Developmental arguments also served to explain the massive expansion of his cabinet by 1984, when Soeharto split government departments and introduced the office of the junior minister (Jones 1984: 161-162). Notably, the presentation of the military throughout most of Soeharto's regime was strong, accounting for up to 40% of all cabinet ministers in the 1970s and almost 50% of the heads of civilian departments in the early 1980s (Bresnan 1993: 109). In the mid- and late 1980s, Soeharto slightly turned away from the technocrats; the appointment of military personnel was institutionalised. Beginning in the mid-1990s, under increasing pressure of political survival, the President generally thought only of his closest and most trusted political and business associates and family members when selecting his cabinet. Crony capitalists stood at the core of the patronage network (Mietzner 2009b: 61).

As Figure 4.1 demonstrates, following democratisation, the number of cabinet ministers was reduced, yet neither significantly (ranging between 25 and 33) nor sustained. On the contrary, the number of cabinet ministers has again been rising, standing at 33 ministers by 2009. This must again be described as bloated. On first sight, one would perceive a continuity of the New Order, yet upon analysis of cabinet members' identities and qualifications, some change is clearly perceptible.

As the previous section has demonstrated all post-Soeharto presidents faced the challenge of political fragmentation and strengthened legislatures. The implications for (and the reactions to) this situation have been largely comparable. The role of the military has been reduced, while the role of political party representatives has significantly increased. Despite interim-president Habibie, who reinstalled more than half of Soeharto's former cabinet, all Reformasi Era presidents resorted to inclusive cabinets, often at the expense of political cohesion and functionality. The appointment of cabinet ministers has become largely the result of a series of background negotiations, deal-making and ‘cow trading’ [*dagang sapi*]. “The coalitions they (i.e. Indonesia's democratic presidents) build are not based on policies or shared values, it's all a matter of power, sharing the power, getting power, getting rents, getting cabinet positions” (Interview: International Organisation Representative).<sup>34</sup>

Wahid managed to secure the presidency only by promising to share the cabinet among all political factions (Kingsbury 2005: 290; Crouch 2010: 31). Megawati appointed ministers from virtually all significant political parties into her ‘rainbow cabinet’ to mitigate the prospects of a later challenge from DPR and MPR. Yudhoyono, while

<sup>34</sup> A similar logic applies to the division of commissions and committees among political parties.



holding a strong mandate as the country's first directly elected president, chose to form a broad coalition in DPR as his party was far from having a majority. However, Yudhoyono set a precedent by requiring his cabinet members to sign contracts and base cabinet reshuffles on performance assessments.

In conclusion, during the period under observation, patronage by cabinet positions was an important factor, yet not the most important. All presidents have taken both personal loyalty and competence into consideration of whom to appoint to which post. What appears to have changed, due to stronger political competition, is the ultimate motive of why patronage is extended. Presidents are no longer in a 'big man' position, their political survival depends on public acceptance, and their political success is strongly influenced by the country's economic elite.

Patronage by positions as presidential advisers, consultants and/or assistants appears to have hardly taken place in Indonesian contemporary political history. During his early years Soeharto retained close ties to a body of four personal military assistants [*Aspri*], which operated comparable to a shadow cabinet. Criticism of the *Aspri*'s dominant role was severe; it was officially disbanded by 1974. At the time of research, legislation provided for twelve individuals as special staff [*stafsus*] for the president, eight for the vice-president, and three individuals for each minister. The perception of special staffs' actual influence on decision-making in politics and administration varies markedly. One politician interviewed perceived special staff as influential, "being all ministers' men or woman. You have to listen; at least you have to pretend to listen. ... They give some kind of pressure in the point of decision-making." An international organization representative interviewed perceived them as not important, as "... they are not part of the decision-making structure, they are on the side and they don't carry much cloud." Finance Minister Sri Mulyani Indrawati (IfSS 2009b) made a similar comment: "In the past the expert staff unit was a place for you to put somebody you don't want". To public knowledge no individuals in excess of the legal provisions are appointed, yet from time to time the creation of temporary executive positions as well as executive positions on probation create the impression of "political appointments through the backdoor" (Interview: International Organisation Representative).

#### *Particularistic use of state resources*

Corruption in Indonesia has been both systemic and endemic, and affects all levels of society. Particularistic use of state resources has not only been accepted in Indonesia, but it has been encouraged as well. "The problem of Indonesian government and administration precisely does not lie in having bad people, but more in having a bad system." (Interview: Politician). Soeharto himself appropriated and distributed public resources for private ends.<sup>35</sup> Officials at lower levels were granted the right to act in a

<sup>35</sup> Transparency International claimed Soeharto embezzled US\$ 15-35 billion between 1967 and 1998. In 2000, he was charged with graft, yet in subsequent years avoided trial arguing that a series of strokes have left him mentally incapacitated. Six years later, based on Soeharto's worsening health condition, the Attorney General controversially dropped the case.

similar way.<sup>36</sup> Salaries of government personnel were kept low, while numerous mechanisms enabling rent-seeking were put in place (Gray 1979: 90; Mackie 2010). Thus, in an effort to compare Soeharto's patronage networks, scholars reverted to the images of a pyramid with him sitting at the apex of power (Liddle 1985: 71; MacIntyre 1991: 7) and the business model of franchising (McLeod 2008b, 2010b).

The main beneficiaries of the New Order's first decade were a comparatively small circle of military officers, civilian bureaucrats, civilian politicians, intellectuals and Chinese entrepreneurs. Yet, by the 1980s, Soeharto's patronage network began expanding massively, including family and friends who themselves were not often military personnel or bureaucrats. Military, politics, bureaucracy and business in Soeharto's Indonesia became fused.

Parties, factions of parties and military commands secured control of various strategic sections of the state apparatus, dividing amongst themselves government departments, banks, state corporations controlling trade, economic policy, resources, credit and contracts (Robison 1990: 38).

Accountability on money flows has been deficient. Neither state revenues nor expenditures were fully accounted for. Though volumes are unknown, it was discovered that many government entities held off-budget funds, and large amounts of government expenditure occurred off-budget (cf. MacIntyre 2000).<sup>37</sup>

With regard to corruption, contemporary Indonesia is characterised by two countervailing trends. Decentralisation, and the following introduction of direct elections on the local level, is perceived to have caused a shift in corruption from the central to the local level. While transparency and accountability on the national level is increasing, the rise of local players has led to a rise in corruption in many provinces and districts. Differences between local government entities are attributed to leadership differences: "Administrative corruption seems to be somewhat lower in districts with good leadership" (von Luebke 2009: 219).

The general impression is, that

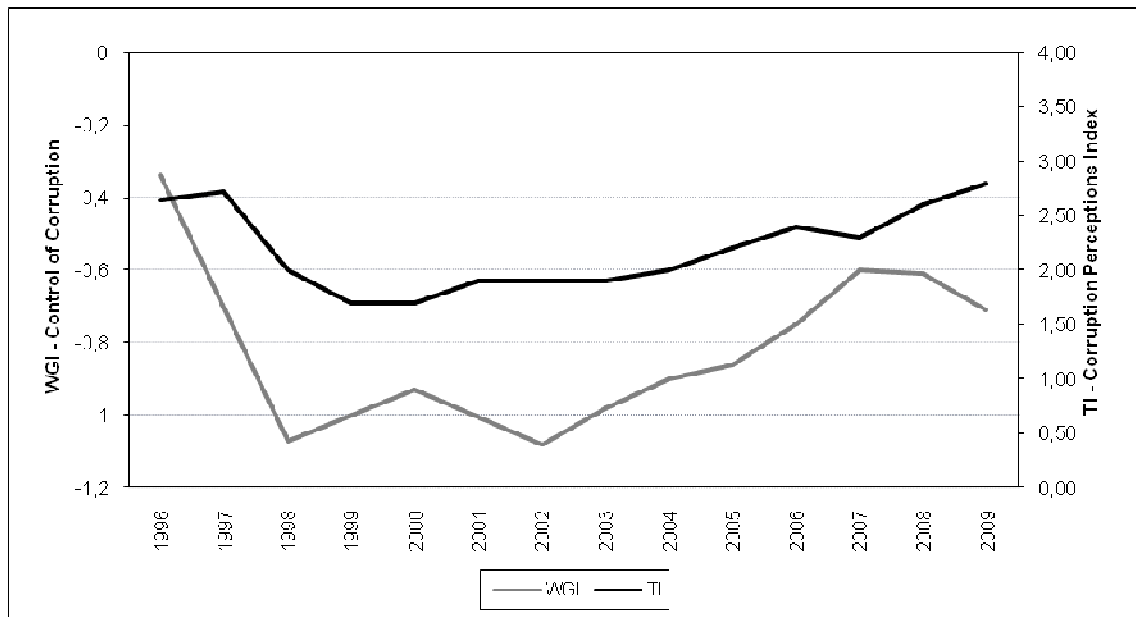
"(t)he primary difference today is not in the amount, but in the pattern. During the period of Soeharto, the pattern was centralised, as everyone made deposits to one point only. While today corruption is spreading with the result that the patrons are also becoming even more. Today we have more players from the bottom level to the highest level until corruption takes place from the smallest to the biggest level" (Interview: Civil Society Representative).

Both Transparency International's Corruption Perceptions Index and the World Bank's Governance Indicator Control of Corruption, however depict an overall positive development with regard to corruption in Indonesia, see Figure 4.2.

<sup>36</sup> Some scholars attributed Soeharto's government style to the tradition of pre-colonial Javanese kings who distributed appanage benefices to supporters, clients and family (see Geertz 1956).

<sup>37</sup> In 2007, Indonesia's Supreme Auditing Board (BPK) identified more than 5.000 illegal accounts containing a total of Rupiah 9.08 trillion (US\$ 1 billion) (KT 08.06.2007).

FIGURE 4.2: *Control of Corruption and Corruption Perception Indices, Indonesia (1996-2009)*



<sup>a</sup> The 'control of corruption' indicator ranges from -2.5 to +2.5, with higher scores denoting "better" outcome. The 'corruption perceptions index' ranges from 0 to 10, with the value 10 denoting the lowest level of perception of corruption. Year-to-year comparisons have to be handled with caution, as changes in score can result from a changed perception, but also from a change in the sample or methodology.

Sources: Author's illustration based on data from the World Bank and Transparency International.

Transparency International reports that overall corruption perception has declined (TI 1996-2009), and the Worldwide Governance Indicator project perceives an increasing control of corruption (World Bank 2009). The apparent discrepancy between the trends described by the interview material and by Transparency International and the World Bank might be attributed to different foci of perception. While the interviewees might have had in mind incidences of corruption, perceptions voiced in World Bank and Transparency International surveys might have been more influenced by the Indonesian government's strong anti-corruption rhetoric and efforts in the investigation and criminal prosecution of corruption-related incidents amongst politicians and public officials. Both perceptions are valid and both lead to the conclusion that Indonesia continues to have a massive corruption problem in absolute terms.

#### *Conclusion: Neopatrimonial Environment of Reforms*

The Indonesian state has long been characterised by neopatrimonialism. All three dimensions have featured consistently, though characteristics have changed. The concentration of power in the president has declined with democratisation. Conversely, the power of elites has since increased. The country's elite dominates national politics, yet neither have the identities of these elites been entirely stable for decades, nor is their

rule unchallenged. Systematic clientelism has a long tradition; the allocation of influential positions is negotiated among political parties and the president. Appointments in excess of legal regulations are kept within boundaries. Corruption in Indonesia has been both systemic and endemic. While corruption on the national level has decreased, it has increased on the local level; overall the problem remains massive.

The analysis of the country's neopatrimonial profile suggests that the preconditions for effective taxation and tax reforms are rather unfavourable. Yet, politics does not seem that captured by the country's economic elite as to be hostile to tax reforms. While sweeping reforms are rather not to be expected, some change seems possible.

#### 4.2.2 Public Administration Concept

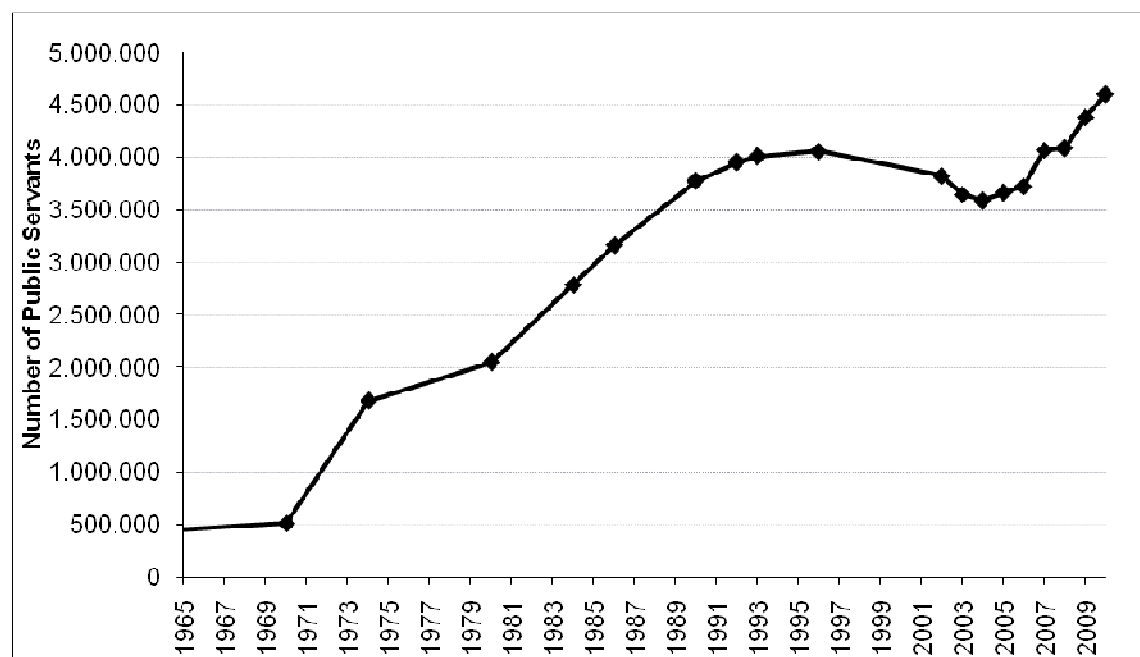
Building upon indigenous feudal structures (Sutherland 1979: 4), the Dutch introduced to Indonesia the traditional career civil service model, also referred to as a closed system model, where civil servants enter from the bottom and are then promoted from within. The late colonial government operated a two-tier system, with the 'first-level' Dutch administration, *Binnenlands Bestuur*, controlling the Indonesian people via the 'second-level' indigenous administration, *Inheems Bestuur* (Rohdewohld 1995: 2-4). Administration was largely organised from Batavia (now Jakarta) and relied on a small number of staff. "Evers/Schiel (1988: 74) estimated the total number of civil servants in 1920 as 81.500, in 1930 as 111.000 and in 1940 as 82.000" (Rohdewohld 1995: 3).<sup>38</sup> The great majority of Indonesian civil servants belonged to the Javanese traditional upper-class, the *priyayi* (literally: younger brothers of the king). Until World War II these native rulers were designated *pangreh praja* (those who administer the state), later *pamong praja* (those who foster the state) (Koentjaraningrat 1985: 274). In the early colonial years, *priyayi* status was acquired by birth into an aristocratic family, later also by education at European lower-schools and subsequent training at the schools for native officials, the OSVIA (Ricklefs 2001 [1981]: 199). Yet, one should not overestimate the formal administrative training provided to Indonesians. Overall, the qualification level of civil servants remained low, as the colonial power's interest centred more on natural resource extraction, commercial trading and control than on a transfer of Western concepts and ideas. Employment in civil service was popular, as *priyayi* enjoyed many rights and privileges over the common people (Palmier 1960: 82; Lev 1972: 252). For instance ex-officio they were entitled to land and to the personal service of the local population. Only by 1910, salaried civil servants were introduced (Bresnan 1993: 102). These privileges and the Javanese concept of power and social hierarchy encouraged a perception of superiority among the staff members of the *Inheems Bestuur*, as well as among their relatives, friends and neighbours. Believing "that working for government entails a higher status compared to working in business or industry" (Interview: Social Scientist) Indonesian civil servants developed the attitude that they "don't serve the people, (but) they would like to be served" (Interview:

<sup>38</sup> To put these figures into perspective: Indonesia's population reached approximately 49.1 million in 1920, 60.7 million in 1930, and 70.5 million in 1940 (Thomas 1969: 498).

Politician). Despite Dutch emphasis on clean administration, legal-rational public service was hardly practiced; rather clients made personal arrangements with individual civil servants and paid “fees” for virtually any documents and services they needed. A proportion of the “fees” raised routinely reached the respective administrations’ off-budget purse and/or private purses. Dutch attempts to bureaucratise and defeudalise the Indonesian civil service “did occur, but they were far from complete, even by the end of the colonial period” (Sutherland 1979: 144).

In 1949, following the transfer of sovereignty, the new Indonesian government replaced the two-tier system of administration with a single civil service system. The exclusive character of the civil service disappeared along with the *priyayi* status. It was replaced with the *pegawai negeri* [government employee] resp. *karyawan* [white collar worker] social class. They transformed the bureaucracy into a massive job-creation machine rewarding those who had been engaged in the armed struggle for independence with civil servant status (van Klinken 2009a: 885). “There was a gross and administratively unwarranted expansion of the government services as politicians strove to provide jobs, reward clients and obtain a following” (Sutherland 1979: 155). As Figure 4.3 indicates, overall the expansionist character was maintained for many decades.

FIGURE 4.3: *Size of the Public Administration, Indonesia (1965-2010)*



<sup>a</sup> Military and police officers, as well as honorarium staff, are not included in the above estimations.

Sources: Author's illustration based on Logsdon (1998: 5-6), Ufen (2002: 222), and BKN (2003-2010).

During the New Order regime, in absolute numbers, the civilian bureaucracy grew more than five-fold. From 1974 to 1984, it increased by 66%, from 1984 to 1994 by 42% (Logsdon 1998: 6). Part of the increase “was due to rapid expansion of services like

education and health” (van Klinken 2009a: 887), but more relevant were nepotistic considerations. Bureaucracy was the place to provide cronies, family and friends with a job in exchange for favours in return, including personal loyalty. Thus, while the low quality of civil service personnel already had taken its toll on administrative efficiency, in many cases primary education continued to be sufficient for hiring (ADB 2004: 62; Harun 2007: 371-372). Only by 1994, falling oil prices forced the Indonesian state to adopt a zero-growth policy. This caused the number of civil servants to level off. By 1999, following democratisation, a minus-growth policy was instituted; except for ‘strategic personnel’. Staff that retired was not replaced. The policy, however, was contradicted when the government passed legislation to lift almost one million honorarium staff to civil servants’ status in 2005 and 2007 (RP 06.06.2009). A new high in the absolute number of civil servants was reached.<sup>39</sup>

As a New Order legacy, human resource guidelines largely “maintain closed hiring and appointment systems that do not encourage appointments and promotions based on competence and performance” (ADB 2004: 58). It is widely believed, that Indonesia’s bureaucracy is not fit for purpose. Muhammad Feisal Tamin and Taufiq Effendi, both former State Ministers for Administrative Reform, estimated that about 65% of civil servants do clerical jobs and are not functional. Only 40% of Indonesia’s civil servants had the skills and qualifications needed to do their tasks properly, the remaining 60% “... are unproductive and have low standards of professionalism. Some go to office just to read a newspaper and many only see their offices once a year” (JP 26.01.2002; G 16.10.2006). Eko Prasjo, Professor of Public Administration at the University of Indonesia and Deputy Minister for Administrative Reforms since 2011, was even more critical of the Indonesian civil service, regarding 85% of its bureaucrats as incompetent and lacking moral integrity (RM 17.02.2010).<sup>40</sup> It is said, that, for example, the Ministry of Home Affairs and the National Planning and Development Agency would still function, or even function better, if its staff members were cut by half (Interview: Civil Society Representative).

At least as problematic for administrative efficiency as the hiring of large numbers of unqualified individuals has been the military-inspired restructurisation of the civil service. Indonesia’s civil service essentially operates by one single blueprint, not paying attention to specific regional and sectoral demands, “no matter the workload, no matter what they do, it’s the same” (Interview: International Organisation Representative). This leads both to redundancy and overlap.<sup>41</sup> Divergence from the blueprint is barely

<sup>39</sup> “By the standards of other countries in Southeast Asia, the civil service represents a relatively small percentage of the population (2%), but it is proportionately the same size as the civil services of the other larger Asian developing countries, India and China” (World Bank 2003a: 96).

<sup>40</sup> Indonesia’s presidents made similarly critical statements, e.g. Megawati Soekarnoputri complained that she would be heading an administration that resembled a “waste-basket” (*keranjang sampah*) (MT 18.02.2002). Also, the general population describes civil servants’ mind-set as “804” mainly with regard to national administration and “702” mainly with regard to the local administration. The meaning is similar, coming to office at 8/7 a.m. going home at 4/2 p.m. and in between 0 productivity.

<sup>41</sup> The nationwide staffing formula prescribes for each echelon I official a support structure of at least four echelon II, 16 echelon III, and 64 echelon IV officials.

possible. At the same time Indonesia's civil service is fragmented and opaque. It operated without an encompassing public administration law. This provides scope for administrative arbitrariness and particularistic use of authority.

Soeharto co-opted the public service. All civil servants had to join the Corps of Civil Servants [*Korpri*] or the respective women's organisation (*Dharma Wanita/Pertiwi*), which were organised along similar lines as his ruling party Golkar. Based on the concept of *mono-loyalitas*, civil servants were urged to always act in favour of the government. Sometimes this came at the expense of public interest. (Thoha 2003: 11; Prasojo 2009: 17-18). According to McLeod (2008a) "[o]ne of the key functions of the bureaucracy was to implement policies that would generate rents on behalf of the beneficiaries of the franchise system". The misuse of public office for private gain hence was frequent. In a 2001 survey, 75% of respondents considered corruption in the public sector to be very common, while around 65% reported actual experience of dealing with corrupt public officials (Partnership 2001). These figures are probably comparable to the New Order situation.

For many decades a market for civil servant positions, transfers and promotions has been in existence (Kristiansen/Ramli 2006). High demand for positions in the public sector, despite the widely held opinion that salaries in the public sector are significantly lower and more compressed than salaries in the private sector,<sup>42</sup> is explained by four factors: relatively low workload, security of tenure, pension entitlement and the many opportunities to legally and/or illicitly augment one's personal take-home pay (Interviews: Civil Society Representative, International Organisation Representatives). Moreover, research indicates that government employees' earnings, when fringe benefits are considered, on average actually are comparable to those in the private sector (Filmer/Lindauer 2001; Synnerstrom 2007: 167-169). Incumbents of managerial positions tend to have more entitlements as well as opportunities to augment their base salaries than incumbents of technical positions. The grade and seniority of the individual are of relevance. These are determined by rank grade, echelon and years in service.<sup>43</sup> Take-home pay in most agencies is composed of the base salary, which allegedly in many cases is regarded as compensation for mere attendance and a "bewildering variety of supplements both in cash and kind" (Gray 1979: 85) which are

<sup>42</sup> "It has been said that the average salary of low level civil servants is less than minimal physical needs (*kebutuhan fisik minimum*) and enables them to live for only two weeks in a month" (Soesastro 2000: 123; see also Panglaykim et al. 1968: 9-10). For a direct comparison of public and private sector managerial remuneration based on year 2007 data see McLeod (2010a: 19).

<sup>43</sup> Rank grades range from I/a (the lowest) to IV/e (the highest). Ranks I through III are divided into four grades (a, b, c, and d), while rank IV has five grades (a, b, c, d, and e), making a total of 17 rank grades. Echelons range from echelon IV (the lowest) to echelon I (the highest). For a complete matrix of the levels and educational requirements in the Indonesian civil service, as still applied by the time of research, see Rohdewohld (1995: 95). For example, in 1970, the head of a major tax office, supervising about 300 employees earned about US\$ 40 per month, while his tax collectors received about US\$ 20 (Smith/Smith 1971: 783). By the early 2000s, a tax office head, whose responsibility included collecting about Rp 20 billion, amounted to about Rp 5 million (Interview: Tax Official Management Level). These amounts are estimates, without transparency no one knows exactly how much a particular civil servant earns.

not in any way meaningfully related to performance, creating distorted incentives. Supplements, by far the larger part of civil servants' take-home pay, are distinguished into those that are legally sanctioned, those that are discretionary and those that are manifestations of bribery and corruption.<sup>44</sup>

Public administration procedures are often excessively complicated. For instance, to obtain a permit ten steps are required rather than a one-stop service provided. As several interviewees maintained this serves to create opportunities: "Functions are created, not that they have anything to do, it is a job creation machine. They need so many functions as it is a mechanism of redistribution of funds" (Interview: International Organisation Representative). Another popular route for civil servants to boost their take home pay is to create and to participate in projects.<sup>45</sup> A politician interviewed alleged, that it is possible that high-ranking officials can take home a higher salary than foreign chief executive officers when they add up revenues from all sources.<sup>46</sup>

In determining an agency's strategic operations, high-ranking officials tend to be very influential, both in the positive and in the negative sense. Paternalism, in Indonesia also referred to as fatherism [*bapakism*] and motherism [*ibuism*], is a widely accepted and practised concept in Indonesian work relations. High-ranking officials take up the role of the father [*bapak*] or mother [*ibu*] while their subordinates take up the role of children, followers, dependents [*anak buah*]. Directions are given by the superior and followed by their subordinates; rarely tasks are completed upon individual initiative, rarely the superior is challenged. In exchange for staff members' loyalty towards their superiors, group interests as well as individual interests are looked after. Collusive networks have organised rent-seeking activities and ensured that benefits are distributed among its members according to well-established patterns. Thus, while internal monitoring, both in the sense of auditing and performance appraisals, formally exists, it is of little meaning. Informal attitudes and arrangements shaping monitoring exercises in many cases significantly reduce the value of assessments.

The issue of reform and modernisation has gained a regular place in popular discourse. Domestic and international stakeholders agree that the structural, organisational and procedural features of the public administration described above are problematic. Routinely, within its key policy documents, the Broad Outlines of State Policy and the Medium and Long-Term Development Plans, the Indonesian government defines public administration reforms as development priorities. According to Rohdewohld (2003: 266), since Soeharto's time, they continue to repeat "the familiar mantra of creating a more 'professional, efficient, effective and responsive' civil service". Yet, "(i)t was not until President Susilo Bambang Yudhoyono took office in late 2004 that there were

<sup>44</sup> Bribery and corruption have also been used to pay for departmental purposes to fund operational costs independently from the state's audit agencies and bribe politicians in exchange for political support and protection (Mietzner 2008: 244-248).

<sup>45</sup> Allegedly, between 30 and 50% of public funds for development expenditures are siphoned off annually (Soesastro 2000: 123; JP 26.01.2008).

<sup>46</sup> Here, one has to remember that Indonesia's salary structure is extremely compressed, with salaries of high-ranking officials being only a relatively small multiple of low-ranking officials.



indications of a strong commitment to reform, albeit with some doubts as to the capacity of the government to see them through" (Synnerstrom 2007: 160). Officially, general public administration reform is underway: a variety of bodies to manage and plan reforms have been established and first pilots started. By the time of writing, however, the pace of modernisation and reform remained unsatisfactory. There has been little evidence of a general reform strategy. Instead incoherence and inconsistency seemed to prevail. It appeared that many initiatives had existed on paper only; only few were effectively implemented.

There is little reformation that they do here and what they do is corrupted partially. ... Decisions are not happening; time is wasted with too many basic questions. Every time it's like starting from the beginning, every time new people are involved start anew. Issues are not put to decision, so they are not decided. Everybody wants reform, but nobody wants change (Interview: Social Scientist).

Various interviewees suggested that many times incumbent politicians, cronies and senior bureaucrats are delaying, circumventing or negating reforms as they are fearful of their own potential losses in wealth and power.<sup>47</sup>

Analysis of Indonesia's public administration concept shows that weaknesses in the bureaucratic system have been long internalized. The Dutch colonial power had not established a fully developed civil service model and fostered civil servants' self-perception of being superior to ordinary citizens. The public service has often been misused for nepotistic considerations; a tradition of merit and qualifications was not established. The organisational structures that had been created are hardly compatible with modern public administration demands. Both the quality and alignment of civil servants remain inadequate and incentive structures flawed. However, need for reform has been acknowledged. In sum, we can presume that the general public administration concept had adverse consequences on the tax administration's operations. Reforms seem possible, yet difficult.

### 4.2.3 Socio-Economic Development

For many decades Indonesia belonged to those countries, where domestic revenue raising was less urgent. Figure 4.4 shows the relevance of the three main revenue components, non-tax revenue referring predominantly to oil and gas revenues, grants, and tax revenue, in the government's revenue collections over time. Arguably, non-tax revenues and grants for many years had an adverse effect on tax revenue collection. For almost two decades the country relied on hydrocarbon exports; more than 50% of government revenues came from export rents. The positive effects of the oil price booms 1973-75, 1979-81 and 2003-08 on the government's budget are clearly visible,

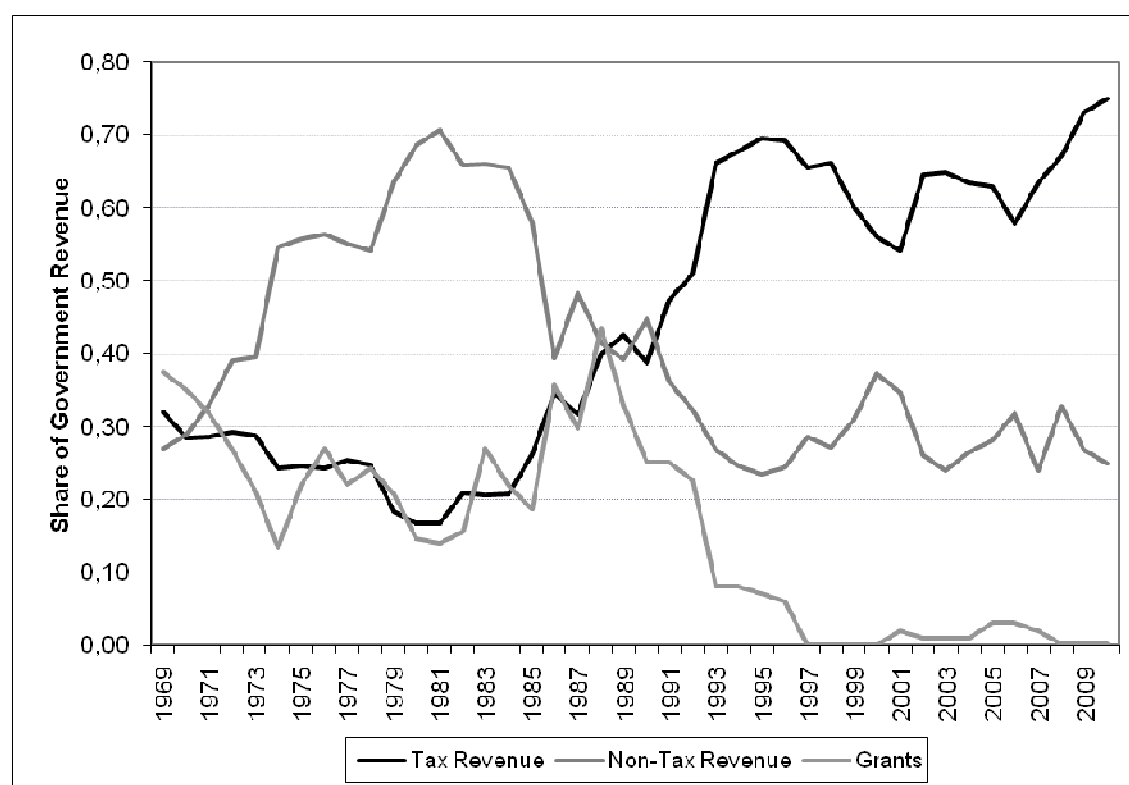
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<sup>47</sup> Of the seven bills for civil service and bureaucracy reform drafted by the State Ministry of Administrative Reform since 2004, i.e. laws on governance administration, public service, amendment to the civil service law, ethics in state governance, authority between central and local governments, public service institutions and non-profit organisations, national supervision system (JP 28.04.2009b), by 2011 only two, the governance administration law (2008) and the public service law (2009), had been passed. However, their implementation and possible effectiveness is doubted (For an evaluation of the public service law see Buehler 2011).

yet what is indicated also is that hydrocarbon revenues are exhaustible, volatile and uncertain. From 1970 to 1980, Indonesian oil revenues appreciated seven-fold, yet in 1981-82 and again 1986 oil revenues began to fall as drastically as they had risen. Foreign aid provided a smaller but also significant share of Indonesia's government revenue. It was particularly important during Indonesia's adjustment period in the 1980s following the deterioration of oil prices. With increasing non-tax revenues, along with grants, tax revenues declined.

With oil prices booming, oil revenue was so high that the relevant ministers did not see any urgency to reform the tax system (Heij 2001: 234). The oil boom induced a lazy fiscal regime. There was no serious attempt to overhaul ramshackle administrative structures, ..., and to ensure tax compliance. ... Non-oil tax revenue, as a percentage of GDP, was well below its potential, or that of comparable countries (Hill 2000: 49).

FIGURE 4.4: *Composition of Government Revenue, Indonesia (1969-2010)*



<sup>a</sup> Available data are weak, hence graphs are to be interpreted as indicating development trends.

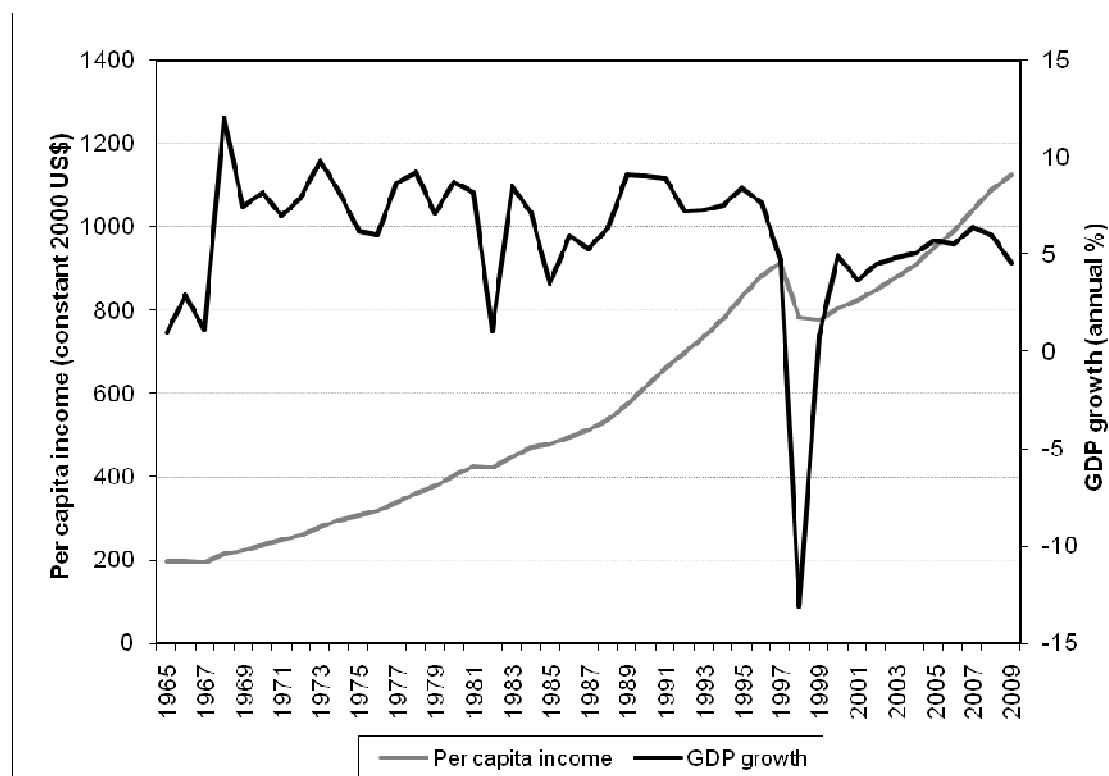
Sources: Author's calculation based on data from *Nota Keuangan* (1969/70-1991/92) as reported in Satiotomo (1998: 23, 24), Brondolo (2008: 10, 39), and Ministry of Finance (2011b: II-28).

Only in the early 1980s the Indonesian government reasoned that “the oil boom was over and Indonesia had been left with an economy facing serious structural problems” (Prawiro 1998: 117). Government acknowledged it had to reduce its dependence on oil revenues and diversify its government revenues in order to achieve longer-term fiscal sustainability (Booth 1992: 41). Between 1984 and 1986, a first set of major tax reforms, focusing on tax policy issues, addressed weaknesses in the tax system (Gillis

1994; Heij 2001). In subsequent years, as tax collection productivity increased and hydrocarbon exports decreased, the share of tax revenues in government revenue markedly hiked. By 2009, the relative importance of the Indonesian government revenues' three main components had been reversed; tax revenues constituted the largest and aid the lowest share. As fiscal sustainability issues became more urgent, the pressure on the government to focus more on domestic revenue collection increased. Past gains in absolute terms have not reached the threshold for fiscal sustainability yet, thus the need to increase domestic tax revenues persists.

Based on its economic situation, Indonesia has good potential to increase its tax revenues. Figure 4.5 illustrates the overall positive trend of the Indonesian economy. Starting from a very low level, following the virtual collapse of economy in the mid-1960s, when Indonesia was described a "basket case" (Hill 1995: 776), a "chronic drop-out" and "the number one economic failure among the major underdeveloped countries" (Higgins 1968: 678)<sup>48</sup>, Indonesia has shown impressive development, being interrupted only by the debilitating effects of the 1997 Asian financial crisis.

FIGURE 4.5: *Per Capita Income and Annual GDP Growth, Indonesia (1965-2009)*



Source: Author's illustration based on World Bank data.

<sup>48</sup> For a narrative account of newly independent Indonesia's economic performance see Booth (2010) and Lindblad (2010).

Setting out as a low income country, with an annual per capita income of US\$ 200 in 1966, at that time the lowest among Southeast Asian countries and also substantially lower than that of Latin American and some sub-Saharan African countries, Indonesia since has shown impressive growth at an average annual growth rate of 6.5%. Per capita income quadruplicated within three decades. With this success story, Indonesia was portrayed as an emerging 'Asian tiger', soon to make its way as a newly industrialised economy. Yet, the effects of the Asian crisis have been strong on Indonesia: the economy contracted by over 13% alone in 1998, hyperinflation reached levels of 80%, the Rupiah drastically depreciated (Soesastro/Basri 1998). Indonesia entered a 'total crisis' [*krisis*], deeply affecting the financial, social as well as political sector, eventually resulting in the fall of President Soeharto (Eklöf 1999; Budiman et al. 1999).

While deeper and longer lasting than expected, a few years after the crisis and into the transition of democracy, Indonesia regained macroeconomic stability (Ananta et al. 2011). By 2004, per capita income had recovered to pre-crisis level and economic growth regained in speed, albeit at somewhat subdued strength. Indonesia managed to reduce central government debt, as percent of GDP, by half, from 71% in 1997 to 28% in 2009. The annual cash deficit fluctuated, but averaged at a comparatively low level of about -1% of GDP, during the last decade (World Bank data). Based on its economic performance, Indonesia, by the time of research a lower middle income country, G20 member state and one of the strongest players in the ASEAN, was considered a Next-11 economy, that is a promising future market showing steady, strong per capita income growth with rising domestic consumption (Wilson/Stupnytska 2007), and a BRIIC country having the potential to rival the G7 by 2027 (Ghosh 2009). Prosperity gains however have not been equitable, reaching all levels of society. "Economic progress has 'trickled down' very unevenly across groups and regions – and often more unevenly than official reports would have us believe" (von Luebke 2011).

According to Forbes Indonesia (02.12.2010), the country's top 40 entrepreneurs hold a combined net worth of US\$ 71 billion, equivalent to one tenth of the annual GDP. Claessens et al. (2000: 108), based on 1996 data, further argued that Indonesia's top 15 families control about 20% of the GDP. These findings stand in contrast with official statistics and academic literature on social inequality. Indonesia's human development index (HDI) improved from 0.39 in 1980 to 0.60 in 2010, while its Gini ratio remained relatively constant at about 0.37 (UNDP data; Asra 2000: 7) and poverty incidence declined (BPS 2009: 50).<sup>49</sup> - Reasons for this contrast are based in data peculiarities and poor statistical coverage in national statistics and household surveys (*Susenas, Survei Sosial Ekonomi Indonesia*). *Susenas* for example hides a great amount of the wealth and expenditures of top incomes, thus understates inequality (Leigh/van der Eng 2009, 2010; Saich et al. 2010: 42-46). If statistics were corrected for their flaws, it is probable

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<sup>49</sup> The HDI is a measure of human development, in which zero indicates low human development and one high human development. The Gini ratio on the other hand is a measure of income inequality, in which zero is complete equality (every individual or household has the same share of national income) and one is complete inequality (one individual or household controls all of national income).

that “well over half of the population would be classified as poor” (Saich et al. 2010: 46). Indonesia's economic elites profit from concealing the country's inequality problems.

While official unemployment in 2011 with 8.12 million people, that is 6.8%, out of Indonesia's total workforce of 119.4 million, is low (DF 05.05.2011), employment in the formal sector is rare. Estimates suggest that at least 70% of the workforce is employed in the informal sector (Nazara 2010: 19-20). A pilot study conducted by Statistics Indonesia in collaboration with the ADB came up with informal employment ratios of 81.9% in Yogyakarta province, a rural area and of 75.9% in Banten province, a more industrialised area (BPS 2010: 59). The share of small enterprises, which tend to be informal, to the GDP output was estimated at 38% (BPS 2010: 2). Analyzing the development of Indonesia's underground economy, Wibowo and Sharma (as cited in Panjaitan 2007: 158) found that its size has increased significantly in processes of transition, whether in tax law, economy or in politics, e.g. in 1984, 1998, and 2000.

The analysis of Indonesia's socio-economic development points to two important factors that have had an influence on the development of the country's tax ratio. First, Indonesia's actual need to raise tax revenues and second, Indonesia's potential to raise tax revenues. With falling non-tax revenues the country increasingly has had to focus more on raising domestic revenues to secure fiscal sustainability. Tax reforms became more urgent. The country's tax potential is large, but so are the hard-to-tax groups which make it difficult for the tax authority to collect. Overall, the economic outlook for taxation is positive.

### **4.3 Administrative Conditions for Reform**

#### **4.3.1 Evolution of the Tax Administration**

Epigraphic evidence suggests that taxation in Indonesia dates back to 10<sup>th</sup> century Javanese kingdoms. As a sign of respect and obedience subjects paid tributes [*upeti*], in cash, kind or labour, to their rulers. Later, in some regions also tax-farming systems were installed. Here, the king provided appanage and appointed appanage holders, who seemingly had no direct relations with the locality, to collect the taxes. Appanage holders in exchange delivered a share of their collections to the king (Hall 1999: 222). Agrarian regions were taxed by share on their produce and forced labour, while maritime regions were taxed on their trade activities (Efendi 2006: 34). A centralised treasury, however, did not exist, tax collection was unsystematic. For the purpose of internal trade taxation, up rivers and along main roads toll houses set up by the king and his vassals were in operation.

With the arrival of the Dutch in the 17<sup>th</sup> century the indigenous population's tax burden became heavier (Booth 1988). Without adequate personnel or logistic facilities to collect taxes directly, the Dutch East India Company (VOC) initially chose to auction monopoly rights for tax collection on goods, services and markets in particular geographic areas [*pachtstelsel*] at annual tax farm auctions to the highest bidding

private individual. Successful bidders were wealthy natives and more often foreigners. In Batavia most taxes were farmed out to Chinese businessmen. Every lease-holder had the right to keep a third of the taxes collected (Moertono 1963: 137). Tax administration was incoherent; it operated differently across the archipelago. Over-charging and extortion, especially of the poor, were frequent. Tax collections often reached “up to six times the rate permitted by the government” (Wahid 2010: 6).

Following the VOC's demise and mounting criticism, both in the Dutch East Indies and the Netherlands, on abusive tax farming operations, the Dutch ceased tax farming and began collecting taxes themselves.<sup>50</sup> Considering the profitability of exports, they introduced a cultivation system [*cultuurstelsel*] by 1830. Indonesian farmers were obliged to deliver export crops production quotas to the colonial power and perform compulsory labour [*corvée, heerendiensten*] on government plantations and public construction sites (Heij 2007: 61). Indonesians referred to the system as forced plantation [*tanam paksa*]. The annual tax burden amounted to a minimum of 20% of total village cultivable land (Paauw 1960: 174), and from 66 up to 200 days of forced labour per household (Robison 1986: 6; Wolters 1994: 176).

Further, based on the concept that land was owned by the king and hence, as the sovereign's successor, the colonial government, many indigenous farmers were subjected to a land tax [*landrente*]. The land tax was first levied in Banten and Kedu, Java, by the British interim government in 1812. Later it became a supporting pillar for the functioning of the cultivation system. Village heads, who were accountable to the colonial administration, were tasked with collecting taxes. In compensation they received a share of their collections. The application of the land tax system was arbitrary and haphazard, as absolute standards and official information on land distribution and its quality were missing. “In no two places did the tax system work in the same way, and one could hardly speak at all of any individual tax assessment and collection” (Hugenholtz 1994: 149).

Assessments of land tax obligations were based upon the *admodiatie* system. This was a practice of negotiating, bargaining and haggling between controllers and village heads. Only by 1920, cadastral surveys of agricultural lands in Java, Bali, Lombok, and Southern Sulawesi, undertaken by the Dutch authority were of a reasonable quality. This permitted land tax to be applied more widely and uniformly (Booth 1974: 57-58).

Nevertheless, the entire tax system was subsequently overhauled. Following the Dutch homeland's example, the tax systems for indigenous and European residents were unified and modern forms of taxation introduced: income tax (1920), excise tax (1924), company tax (1925), real estate tax (1932), motor vehicle tax (1934), and wage tax (1935) (Efendi 2006: 41). The replacement of labour services on the entire territory with modern forms of taxation took until 1941 (Cribb 1994: 42).<sup>51</sup>

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<sup>50</sup> The Dutch had replaced the VOC in 1800, and re-established their rule after the British interregnum from 1812-1818.

<sup>51</sup> For a detailed reconstruction of government revenues in the Dutch East Indies between 1821 and 1941 see van Zanden (2003).

With the declaration of independence, taxation was formally included in the Republic of Indonesia's 1945 Constitution. Article 23-A states that "All taxes and other levies for the needs of the state of a compulsory nature shall be regulated by law". Further constitutional provisions were not made. The new Indonesian government adopted, partly amended and extended the former colonial ordinances, e.g. by introduction of a general sales tax in the early 1950s.<sup>52</sup> The authority to collect taxes was shifted from the Department of National Revenue [*Dienst voor de Landelijke Inkomsten*] (Efendi 2006: 52) to the Indonesian Ministry of Finance. Since, various tax collection services existed parallel to and essentially independent from each other: land tax service [*jawatan pajak bumi*], auction service [*jawatan lelang*], tax accounting office [*jawatan akuntan pajak*], customs and excise service [*jawatan bea dan cukai*] and tax service [*jawatan pajak*].<sup>53</sup>

Outreach in the early years was sparse, with few regional offices [*Itda, inspektorat daerah pajak*], 4 in 1963, 8 in 1966 (Oberndörfer et al. 1976: 62, 72), constituting the second level. The *Itda* were tasked with tax assessments, while common village officials continued to collect the taxes due. With the exception of the wage tax, which was a withholding tax, all taxes were personally collected from the taxpayers. Later, the village officials were replaced with a professional third level, the tax inspection offices [*KIP, Kantor Inspeksi Pajak*], post offices and banks. In 1960, 15 KIP existed (Oberndörfer et al. 1976: 62, 164). Overall, the tax system was weak and the administrative capacity low. It was "incapable of capturing a significant share of increments in domestic income which does not flow through the foreign-trade sector" (Paauw 1960: 178-179). In 1965, almost 75% of taxes were indirect taxes. Direct taxes were rare (Anonymous 1966: 7).

In 1967, government merged the different tax administration services and established the Directorate General of Taxes [DGT, *Direktorat Jenderal Pajak*]. The KIP were renamed KPP [*Kantor Pelayanan Pajak*] and the number of national level offices increased to 60. The number of tax collectors was increased by "training redundant officials from the Department of Finance and other government departments" (Arndt 1967: 22). The tax system reflected the low importance of taxation to the state.

Major tax reforms were initiated only following the decline of oil revenues. Pressures for earlier reforms did not exist, as state revenues from oil and gas were high and most stakeholders were satisfied with a tax system which extracted little from private income, demanded little administrative effort, and provided opportunities for illicit practices.

In fact, the impression remained, that "forces resisting reform are powerful and pervasive. On the one side, there are the holders of office, civil or military. Inevitably, through formal and informal, legal and extra-legal channels, they use their power, in some measure, to protect their personal interests or those of their families, their military units or government departments or regions (Arndt 1968: 27).

<sup>52</sup> These laws continue to form the core of the Indonesian tax system.

<sup>53</sup> By 1965, the land tax service was renamed to Contribution to Regional Development (*IPEDA, Iuran Pembangunan Daerah*). Reportedly, this was an attempt to replace the negative connotation of the colonial exploitation related to land tax. In 1985, IPEDA then became the Directorate of Land and Building Tax (*PBB, Direktorat Pajak Bumi dan Bangunan*).

Indonesia's early tax reforms, while supposed to be encompassing and comprehensive in nature, in fact focused more on an overhaul of the tax structure than on modernisation and reform of the tax administration. After almost three years of preparation, they commenced in 1983. The reforms were largely designed by policy analysts and advisors, notably consultants from the Harvard Institute for International Development, who worked from an office near the Finance Minister for almost three decades (1966-1994) (Gillis 1989a; Cole/Slade 1996; Stern 2000), but initiated by technocrat Finance Minister Ali Wardhana and backed by President Soeharto (Glass Burner/Poffenberger 1983: 12-16).<sup>54</sup> They involved the introduction of a fully revamped general tax procedures act, a complete overhaul of corporate and private income taxes, domestic indirect taxes and property tax, and the abolishment of several stamp taxes. Moreover, a withholding pay as you earn system and self-assessment, transferring the responsibility for determining the tax reliability, tax return filing and taxpaying to the taxpayer, were introduced. Soeharto's decision-making power was a key to the introduction of reforms.

Reforms were successful in so far as tax revenues increased. The introduction of the value-added tax was regarded a major success.<sup>55</sup> However, the overall assessment of reform outcomes was tarnished, as "those tax proposals that might have created social unrest or economic or political instability never made it into the final version tabled in parliament" (Heij 2001: 247). Measures to reform tax administration practices, e.g. by placing more emphasis on the withholding system, electronic tax data collection, storage and processing, and intensified (re)training of personnel, fell short of expectations. Tax administration reforms were "viewed as an adjunct rather than integral to the reform process" (Mookherjee/Das-Gupta 1998: 418) and moreover met little support from senior officials. "For the tax collectors themselves, 'tax reform' was nothing more than a euphemism for income reduction" (Prawiro 1998: 231).

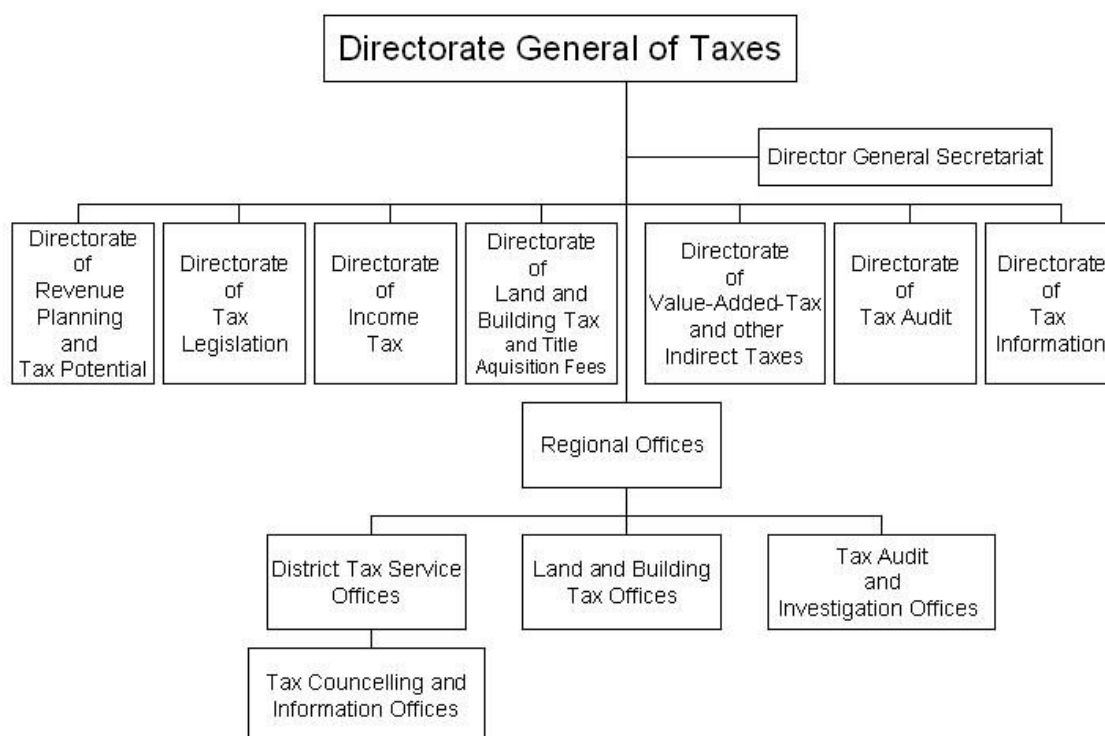
Only by 1994, the institutional structure of the Directorate General of Taxes (DGT) was overhauled. Figure 4.6 illustrates the DGT's organisational structure prior to the tax administration reforms initiated in the early 2000s.

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<sup>54</sup> Dialogue with taxpayers and business associations was insufficient. Similarly tax officials felt that they were not sufficiently included in the reform planning process.

<sup>55</sup> The VAT to GDP ratio increased from 1% in 1984, to 2.4% in 1985 and nearly 3.5% in 1988, exceeding all projections and expectations (Shalizi 1991: 32).



FIGURE 4.6: *Pre-Reform Organisational Structure of the Directorate General of Taxes*

Source: Author's illustration based on Directorate General of Taxes (2002).

Subordinate to the Ministry of Finance, DGT, has had little organisational autonomy. Based on the personnel complement, the DGT is the ministry's largest directorate. It is made up of a hierarchical three-tier system, consisting of headquarters at the national level, regional offices at provincial level and tax offices at district level.

A Director-General, appointed by the President, leads the DGT. Headquarters, located in Jakarta, is the main policy and planning tier. Its organization with one general secretariat and eight directorates, did not allow "to effectively manage ongoing operations and develop new tax administration programs" (Brondolo 2008: 15).

Regional offices are primarily a management tier, executing plans and policies issued by headquarters. Further they coordinate and monitor the performance of the district tax offices and units within their area of responsibility. Overall regional tax offices have little direct contact with taxpayers.

The tax offices at district level handle all taxpayer matters. Before the 2000s reforms, these offices were separate and operated virtually independent from each other, administering different types of taxes, and performing audit and investigation functions. District tax service offices performed service, inspection and collection functions relating to income tax, value-added tax, sales tax on luxury goods and other indirect

taxes. Tax Counselling and Information Offices conducted taxpayer information and communication programmes, in addition they conducted parts of the district tax service functions, especially in Indonesia's remote areas. Land and Building Tax Offices performed service, inspection and collection functions relating to Land and Building Tax and Fees for the Acquisition of Rights to Land and Buildings. Tax Audit and Investigation Offices conducted law enforcement functions through tax inspection and investigation.

By 1996, the DGT, in addition to headquarters, comprised 15 regional offices, 141 district tax service offices, 107 land and building tax offices and 55 audit offices, totalling to 303 offices at third level (Brondolo 2008: 15).

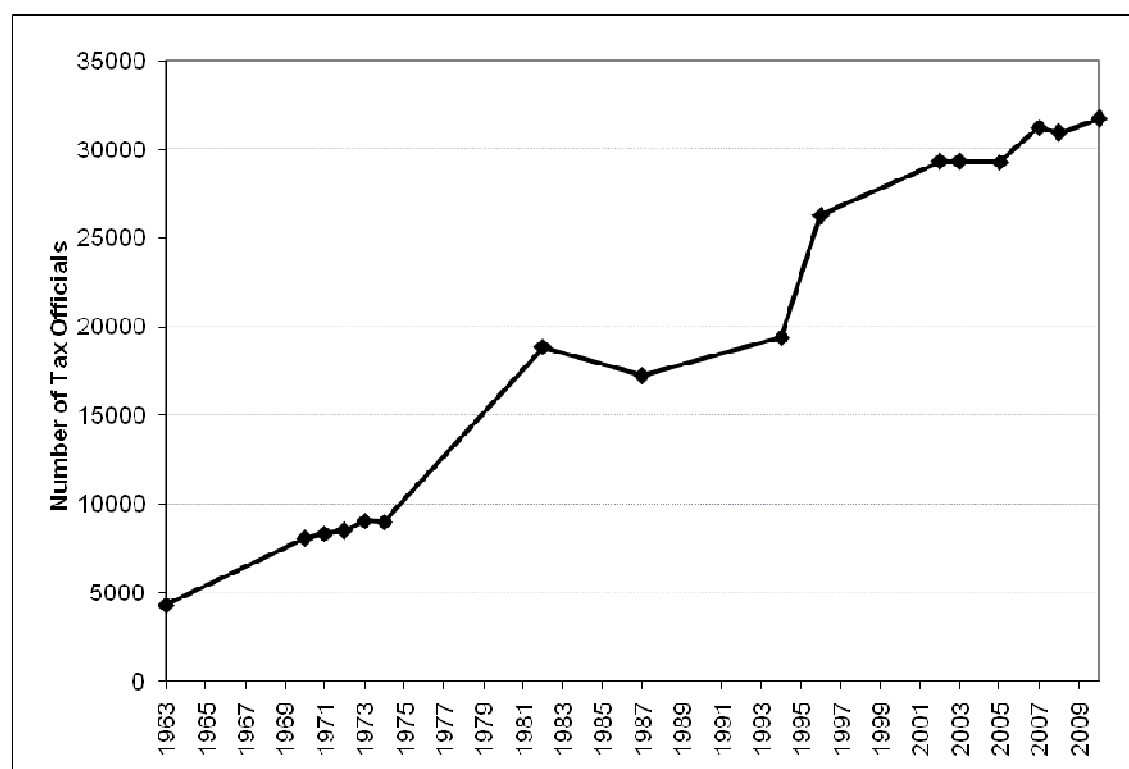
The analysis of the tax administration's evolution points to four issues that are of particular relevance for this study: Taxation has a long tradition, yet the way it was exercised in pre-colonial and colonial times created a negative impression of taxation; that of forced contribution and extortion. Tax administration has been weak, as it first has been neglected for decades and second complexity within tax administration was welcome. Tax administration reforms at large were unpopular. This indicates wide scope for reforms, but also that path dependence has been strong. Reforms hence are unlikely to be a smooth journey.

#### **4.3.2 Human Resource Management**

Among the most serious problems affecting the DGT's collection capability and performance have been staffing issues. Figure 4.7 shows an estimate of the growth in tax officials employed with the DGT during the past 50 years. Considering Indonesia's population size, the size of the tax administration with 4.300 employees in 1963, 18.800 in 1982 and 32.000 in 2010, is small. One tax official per 1.000 population is "the international benchmark, or norm" for tax administration size (Gallagher 2005: 137). Indonesia has consistently failed to meet the benchmark; starting off with 0.04 in 1963, 0.12 in 1982 and a constant of 0.14 since the mid-1990s.<sup>56</sup>

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<sup>56</sup> In comparison, some countries, like Germany with 2.10 tax officials per 1.000 population exceed this benchmark, others like Australia with 0.97 or the United States with 0.92 do more or less meet the norm, and again others like Sri Lanka with 0.08 or India with 0.05 fall far behind the benchmark (Gallagher 2005: 138; Martinez-Vasquez 2006: 45).

FIGURE 4.7: *Size of the Tax Administration, Indonesia (1963-2010)*

<sup>a</sup> Honorarium staff is not accounted for, as their numbers are unknown.

Sources: Author's illustration based on data from Oberndörfer et al. (1976: 72), Das-Gupta (1998: 415, 420), DGT Annual Reports 2002-2009, and Brondolo (2008: 15).

Yet, for many decades, in relation to registered taxpayers, the workload on tax officials statistically has been comparatively low, e.g. 16 registered taxpayers per official in 1982, 63 in 1996 and 112 in 2003 (Author's calculations).<sup>57</sup> Therefore, we may doubt that its small size is the DGT's primary problem. The analysis of formal human resource management policies, their actual application in staffing decisions and the consequences thereof point to further issues affecting the tax authority's operations.

Like all other Indonesian government institutions, the DGT operates a hierarchically structured career civil service system; employees enter from below and reach more senior positions from within. Lateral entry into the ranks from the outside is not possible. Recruitment is not based upon specific skills, but the attainment of certain educational levels. The recruited originate both from STAN, the State College of Accountancy, and other national educational institutions. STAN is affiliated with the Ministry of Finance. It admits students with a high school degree following entry examinations and offers Diploma I, taking one year of full-time study, and Diploma III, taking three years of full-time study, courses in public finance. Graduates from other national educational institutions, which are in the minority, hold backgrounds ranging

<sup>57</sup> Registered taxpayers serve as a proxy as the number of active taxpayers is not available. The actual number of taxpayers which fall into the responsibility of one tax official therefore is lower.

from primary school leaving certificates to post-graduate degrees in accounting, law, public administration and information technology.

Annual recruitment has been based on the national staff establishment [*formasi*], i.e. the number of approved positions by the state ministry for the state apparatus and bureaucracy reform and the state budget. Professional, strategy-oriented human resource planning has not taken place. Specific operational needs and actual workloads of directorates and sub-divisions were hardly taken into consideration, rather organisational units of similar size and staffing levels were created. This left some units overstaffed and others understaffed. Tax officials have not been hired for specific functions, but assigned to individual units. Job descriptions defining key positions, related functions, responsibilities, authorities and reporting relationships have not existed. Individual job assignments were unclear.

Tax officials, apart from honorarium staff, are recruited in nationwide public recruitment campaigns conducted by the Ministry of Finance. Since the 1980s, recruitment opportunities were publicly announced in local newspapers, prior to that only specific universities were directly approached. Applicants may specify a preferred directorate, yet passing candidates are allocated by the ministry, which means that they do not necessarily end up in the directorate they desire. Similarly, the DGT cannot decide which candidates to hire. It receives its annual tranche based on the ministry's decision. The entrance examinations, since their introduction in 1972, have always attracted a multiple of applications than positions advertised and are said to have been more competitive than those of most other government departments ever since. In 1973, 35.000 individuals applied for a position at the MoF, of those 21.000 took part in standardised examinations, which assessed candidates' general knowledge and English language skills. Only 2.600 passed and were recruited, 90% failed due to insufficient English language skills (Oberndörfer et al. 1976: 83).

Anecdotal evidence however suggests that the recruitment process, as competitive as it seemed, similar to Indonesia's entire civil service has contained loopholes allowing for the manipulation of formal rules and procedures, compromising/undermining the merit principle (Setyowati 2009: 11). Positions at all levels of the DGT have been highly sought after, as they promised salaried studies and life-long, legal and illegal income-earning opportunities. This tempted individuals to invest in obtaining positions at the tax authority. Allegedly, there have been occasions when 'deputies' were placed in entry examinations, bribes paid to HR staff, and support from influential personalities was sought, to improve the chances of being accepted. Nevertheless, the overall impression of the persons interviewed for this study was that recruitment at the DGT still has been "comparatively better than in other departments" (Interview: Tax Official Management Level), less influenced by particularistic interests and less penetrated by politicization (Interviews: Other Government Officials, Business Representative, Politician, International Organisation Representatives).

Despite the comparatively better selection of staff, the majority of DGT's employees have potentially been under-qualified to carry out the complex tasks required by a

modern tax administration. According to Oberndörfer et al. (1976: 84), in the 1970s about 70 to 80% of DGT's staff population was clerical staff with low educational levels. While the ratio improved over time, the overall staff quality level remained a concern. By 2002, 40% of DGT employees held the maximum of a high school diploma, about 30% in addition had completed one to three year courses and less than 30% had completed studies at Bachelor level or higher. Further, the professionalization and efficiency of tax administration seemed impeded by an inadequate allocation of tasks and related workloads among individuals employed with the DGT. Several tax officials interviewed, both at management and middle level, claimed that based on overall workload and absolute number of tax officials, DGT at present was actually not understaffed.

What occurs is hidden unemployment. ... there are a large number of employees. But what work are they performing? We do have enough employees; they are just not efficiently directed (Interview: Tax Official Management Level).

We do have a standard, which allocates between 110 and 120 positions to district tax offices. At present, there are only 80 people working at our office. Yet, we do not feel having a shortage, as we work well, by system. If we make use of our employees to the maximum, there is enough staff (Interview: Tax Official Management Level).

The crux of the problem seems to be, that staff allocation is not aligned with the area of risk. The proportion of administrative people, in comparison to technical staff, is very high. It is estimated that about 90% hold structural positions, of which approximately 4.000 are managerial (Echelon I-IV) and the remaining 22.000 are administrative or clerical staff. Structural officials are expected to perform any tax administrative function and act in any general administrative position. The remaining 10% hold specialised functional positions. Auditors, lawyers and IT personnel are limited.

While auditing is one of the core functions of the tax system, the DGT falls far short of the international benchmark of about 30% of tax administration staff assigned to audit functions (Gallagher 2005: 137). To meet the benchmark, in Indonesia's case more than 7.000 tax officials should be assigned to auditing, estimates however point out that the number of auditors at the DGT amounted only to 1.500 in 1998, and 2.271 in 2002 (Mookherjee/Das-Gupta 1998: 425; DGT Annual Reports).<sup>58</sup> With auditors responsible for carrying out a minimum of eight audits per year, 16 since the mid-2000s, and these principally being VAT-refund claims which by law are mandatory to undergo audit regardless of the amount claimed, the general audit risk for Indonesia's taxpayers is low. Similarly, the pronounced absolute lack of qualified lawyers and IT personnel leaves room for discretion and interpretation pertaining to the definition and calculation of tax liabilities. Low risks and wide discretionary room establish opportunities.

Trainings for tax officials are conducted by the tax education and training unit [*Pusdiklat Pajak*] of the ministry of finance's education and training centre [*BPPK*]. Yet, training measures so far were insufficient to adequately educate staff and provide them with the skills and knowledge needed to perform their roles and responsibilities

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<sup>58</sup> At the time of interviewing, DGT had formulated its internal target as 6.000 auditors.

effectively throughout their career. First, it seems reasonable to assume that 60% of DGT staff actually cannot be trained to 'upgrade' their skills and knowledge to match today's requirements as their educational capacities are deficient (Interview: Tax Official Management Level). Second, the number of staff at Pusdiklat Pajak has been relatively small compared to the DGT's size, restricting the number of tax officials that can actually be trained.<sup>59</sup> Third, syllabi and training material have been partly prescribed by the National Institute of Public Administration [*LAN*], and not necessarily related to tax administration functions. Three types of trainings have been provided: structural, technical and functional. Structural courses are divided into (1) pre-position courses [*prajabatan*], targeting newly hired tax officials and training them on general public service related issues, and (2) leadership training courses [*kepemimpinan*], for which participation is limited and which are a prerequisite for promotion. Structural courses have been in the focus of tax officials' interest. Anecdotal evidence, however, suggests that the importance of these courses has not been based upon the knowledge and skills they are supposed to provide, but upon their disguised function as a marketplace for job positioning and job promotions.

As pre-position courses are compulsory for all new tax officials, it is in particular the large discretion of instructors in staff appraisal which opens up opportunities for transgression in placement decisions. DGT's tax offices are divided into offices in Jakarta and outside Jakarta, in Java and outside Java, and also informally, according to the possibilities for earning additional income, into wet and dry offices as well as wet and dry sections. Theoretically, any tax officer within echelons II - IV can be placed in any office, be it in headquarters in Jakarta or in far-flung regions, as the absolute willingness to travel and move is part of their employment contracts. Only non-echelon staff can remain within their region. A junior tax officer reported that favourable appraisals, which are regarded as important for being placed into desired offices, for many that is those in Java which offer a better living quality and are closer to home and/or those offices outside Java with high tax liability occurrences from large profitable companies or high wealth individuals because opportunities for rent-seeking are higher, are not based on actual performance alone, but influenced by bribing course instructors and superiors in the pre-placement tax office in cash or kind (ICW 2000: 4).

DGT's rotation policy requires the transfer of staff between functions and geographic locations every three years. Positioning has not only been based upon merit and qualifications. In many cases, rotation decisions have been taken without participation or even consultation of the staff concerned. In other cases, a tax officer's personal relations and willingness to bribe are said to have influenced where an individual had to move. Rumours circulate saying how much one should pay for certain positions. The lack of professional criteria and set performance standards has created a culture of intransparency. The annual staff appraisal [*DP 3, daftar penilaian pelaksanaan pekerjaan*] did not have a real meaning amidst a society reluctant to open criticism.

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<sup>59</sup> In 2002, 2.526 employees took part in career education and training, 1.116 in professional education and training (DGT AR 2002: 5).

Simple questionnaires, concerned with allegiance, performance, responsibility, compliance, honesty, cooperation, initiative, and leadership qualities, were completed by the superior, not by a wider team, and the validity of their judgments has never been examined nor disputed. In consequence, as a tax official wrote

If a particular supervisor does not happen to like you or does not rate highly for whatever reason, he or she is fully entitled to use any of the hundreds of civil service regulations and ignore the others in making their assessments. This record will then stand for the rest of your career (II 16.12.2007).

Individual judgments of superiors have been of great importance. "We did not know why someone was shifted and we could not predict where next we were likely to be placed" (Interviews: Tax Official Management Level). "In the past there have been many issues as there has not been any pattern. In the past the decisive factor could have been closeness with senior staff" (Interview: Tax Official Middle Level).

To acquire knowledge for a new position or broaden their knowledge in a specific topic, during their career, tax officials were offered technical, targeting tax officials holding structural positions, and functional courses, targeting those holding functional positions. These courses have focused on the generic instruction of general knowledge and related subject matter relevant to work implementation. Until 2007, training was largely supply driven. As neither strategic planning nor structured training needs analysis nor performance management has taken place, actual on the ground training needs have been insufficiently addressed. Further, as participation in courses has been voluntary and apart from structural courses incentives for enrolment have been low, many tax officers actually in need for training, have not been trained. According to a middle-level tax official interviewed, many of the low level old-aged staff thus pose serious problems as it gets increasingly difficult to place them in positions they are qualified for. In some cases they can only be assigned to sort, staple and file papers, a task which gets even more redundant as modern information technologies enter the DGT. This is problematic, as until the official retirement age of 56 years for civil servants is reached, the DGT is almost powerless in removing staff that are not performing. Moreover, even of those participating in trainings not necessarily any skills improve, as trainings can be misused as mere opportunities for earning additional income via per-diems and moonlighting. Performance criteria for measuring the success of courses did not exist; genuine exams for passing a course essentially have not taken place.

Traditionally, promotion has depended upon seniority and rank, and the attendance of structural training. Conformity with the organisation counted more than merit. Promotion more or less has taken place automatically every four years. Criteria on which promotions to certain positions are based however were not clear. Official criteria, such as initiative, diligence and performance, only existed on paper. As such individual career planning has not existed and the arbitrary appearance of decisions gave rise to dissatisfaction amongst DGT staff. The common perception has been that, "promotion has not always been fair" (Interview: Tax Official Middle Level). "People have been moved up the ladder not because of their capacities and leadership skills"

(Interview: International Organisation Representative). A tax official who himself had risen up the ladder during his career interviewed recounted that he personally experienced cases when not a group's "rising star" was chosen but someone of lesser qualities. Depending on the senior management staff, there have been times when one could guess who would be promoted and times where many questions came up. Instead of being the result of internal competition for openly advertised positions, promotions often have been the result of 'entitlement' and management decisions. The closer a tax official was with senior staff, the greater the opportunities.

In general promotions have been internal decisions of the Directorate General of Taxes and the Ministry of Finance, free from external interference. Only the Director General has been a direct political appointee and not necessarily been a career tax official. Upon suggestion by the Minister of Finance, and following deliberation with a selection team, the President appoints and removes the highest-ranking tax official.

Who is placed in this position is decisive, as the director general holds strong and wide-ranging powers, and largely prescribes the manner in which the tax authority operates. During the New Order, the DGT experienced six director generals, with an average length of tenure of 5.3 years, pointing to both stability and regular turnover.<sup>60</sup> While the pattern of turnover of the minister of finance and the director general of taxes has not been parallel, the role of technocrats in Indonesian economic development in particular and in Indonesian politics and administration in general is also mirrored in the appointment of the directors general of taxes. As long as the DGT was of little relevance for financing the state, DGT directors general were left with wide-room in 'managing' Indonesian taxation. Yet, when, in view of the oil crisis, substantial tax reforms were required, technocracy became more important. Finance Minister Ali Wardhana replaced the long-serving Director General Sutadi Sukarya (1970-1980) to restructure the DGT and curb rampant corruption (Heij 2007: 71). His successor was Salamun AT (1981-1988), later replaced by Mar'ie Muhammad (1988-1993). The image of both was that of clean and capable technocrats. During their leadership tax revenue steadily increased, compare Figure 4.4, indicating their affirmative role in pushing through tax reforms. This positive trend came to a hold in the early 1990s when businessman Fuad Bawazier (1993-1998), a Soeharto crony and associate of Soeharto's children, was appointed Director General. As technocrats' power in general politics waned, so has the role of technocrats in tax administration. The then Finance Minister Mar'ie Muhammad was powerless in keeping the DGT under control. Tax collections suffered a slump. When economic crisis stroke, tax collection suffered another slump; overall this trend could be reversed by Bawazier's successors Anshari Ritonga (1999-2000), Machfud Sidik (2000-2001) and Hadi Purnomo (2001-2006), yet their leadership was not perceived without any controversy.

The analysis of DGT's human resource management indicates that both its characteristics and the ensuing weaknesses are comparable to those of Indonesia's entire

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<sup>60</sup> For a comprehensive overview of the tenure of office of presidents, coordinating ministers of economic affairs, finance ministers and director generals of taxes between 1968 and 2011, see Appendix I.



civil service. Partly, this has been an outcome of the DGT being subject to Indonesia's general rigid civil service rules and procedures and their (un)intended consequences. Further, the neglect of merit and qualifications exerted adverse effects on the tax administration's capabilities and operations. Staff appointment, training, transfer, promotion and termination do not fulfil the needs of an effective and efficient tax administration. Numerous weaknesses and shortcomings originated in the past and survived for decades.

### 4.3.3 Business Operations

Asking what is wrong with the tax administration, an answer one frequently receives is: "There are business processes in place that permit leakage of revenue" (Interview: International Organisation Representative). In the following, this argument is explored.

#### *Registration*

The majority of Indonesian individuals and companies have been able to avoid tax payments, as the DGT did not have a systematic and consistent approach to register taxpayers. For instance, by 1973, only 10% of households in Jakarta's most affluent sub-districts Menteng and Kebayoran Baru were registered with the tax office (MT 18.08.1973).<sup>61</sup> The formal obligation to register for income tax has not been enforced. Tax officials spent most of their time in their offices, working on and with what they got. Some businesses and individuals, for their political clout, while known by the DGT were "untouchable"; others were "invisible" to the DGT.

Information on where to find potential taxpayers was missing, not only because the quality of Indonesian statistics concerning income and earnings, asset ownership and business transactions of households and firms has been poor, but even more because the tax administration neither adequately processed and analysed their own data nor used third-party sources, including other MoF directorates', for data matching and mining. Attempts to widen the tax base lacked political will, professional skills and values. Tax return forms were 'selectively' send to potential taxpayers and door-to-door visual spot checks conducted, however follow-up inquiries or even formal enforcement actions against the 60 to 80% of individuals and firms which did not respond were not conducted (MT 18.08.1973; Lerche 1978: 182, n. 1). Similarly, the reintroduction of the tax assistant [*mantri pajak*], as the "eyes, ears and feet" of the taxation office in pilot villages [*kelurahan*], whose tasks according to the DGT's Secretary General were "to note down what they see and hear, and report this to the taxation office, but not to investigate or determine tax liabilities" (MT 05.10.1974), proved ineffective. Some observers criticised it as a mere waste of resources. Upon high-level order extensification measures were suspended and the DGT left rather unattended.

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<sup>61</sup> Registration does not mean that tax returns were filed correctly or filed at all. For instance, in 1972, the DGT collected taxes only from 17.000 of Jakarta's 38.000 that were registered for income tax (MT 30.12.1972).

Only following the increased need for tax revenues in the 1980s, efforts to raise the number of taxpayers became more vigorous. Government required all civil servants, who previously had been exempted from paying taxes, to register, and offered a tax pardon for others who registered voluntarily before mid-1985. This initiative almost doubled the number of registered corporate and individual taxpayers from 550.000 in 1983 to 995.000 in 1985 (Nasution 1989: 41).<sup>62</sup> In the 1990s, taxpayer registration was made mandatory for applicants of electricity contracts, telephone connections and car registration (DGT 1994). Yet, until 2001, the year before administrative reforms officially began, the number of registered taxpayers had risen only to 2.3 million. This indicates that the policy was not followed rigorously. The tax administration has had particular difficulties in widening the tax base to incorporate the informal sector, middle class self-employed professionals such as lawyers, doctors, dentists, artists, and the seriously wealthy.

Contrary to original intention, taxpayer registration and taxable entrepreneur numbers (NPWP/NPPKP) were neither unique nor permanent. Apart from data recording errors, which occurred frequently due to the prevalence of manual entries in tax inspectorate offices, it has not been uncommon for Indonesians to have several registration numbers, both for formal and informal reasons.<sup>63</sup> As local tax service offices individually assigned NPWP, by definition some taxpayers have had several tax registration numbers as they were dealing with different tax offices or moved from the jurisdiction of one office to another. Other taxpayers applied for NPWP using different addresses or names and/or applied at different offices, to save on taxes they would have to pay. Anecdotal evidence suggests that at times a NPWP was used for one individual transaction only and abandoned after the transaction had been completed. The multiplicity of NPWP has been problematic in many different ways. First, it has been difficult to identify a taxpayer unequivocally, second, exacerbated by the hardly existent vertical communication and exchange between the different types of tax offices, it has hardly been possible to see the complete picture of a taxpayer's financial assets and transactions, third, exacerbated by the flawed horizontal communication and exchange between local offices, regional offices and headquarters, it has been virtually impossible to construct the full history of a taxpayer's taxation affairs through the years.

### *The problem of exemptions*

Several times in Indonesian taxation history, politics granted controversial, preferential tax privileges and incentives.<sup>64</sup> Officially, the purpose of tax holidays, exemptions and

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<sup>62</sup> This amounted to 0.6% of the Indonesian population in 1985.

<sup>63</sup> Similarly, it is common for Indonesians to be in possession of multiple identity cards (KTP), driving licenses (SIM) and family cards (KK), as data across district administration offices (*kelurahan*), which are responsible for issuing identity cards, is hardly cross-checked. In Jakarta alone, up to 250.000 people are officially suspected of holding at least two identity cards (ST 09.09.2011).

<sup>64</sup> Tax privileges and incentives, in the form of tax holidays, dividend taxes, investment allowances, and carry-forward losses, have been frequent in the 1970s and early 1980s. Under pressure, government eliminated these in 1984 (see Winters 1996: 168-184). Yet, they were reintroduced in 1993.

concessions was to support the country's development strategy by attracting and supporting investment activities (Wells et al. 2001: 5), however at different occasions it became apparent that "protection from the tax office is one form of patronage that Soeharto uses to secure the loyalty of influential members of the Indonesian elite" (Schwarz 1994: 65). The numerous foundations [*yayasan*] led by Soeharto and his cronies, which operated as financial institutions, officially with social and charitable objectives, but unofficially also served as a medium for disguising profits, laundering money and accumulating wealth, were exempted from tax payments and related audits during the New Order. Tax administration has been ineffective:

By 1981, the tax system had become a maze of virtually unenforceable amendments, decrees and regulations that proceeded from a long series of ad hoc measures enacted with little reference to one another. ... Tax policy ... yielded a tax structure so interlaced with complexity as to be almost inadministerable (Gillis 1994: 18).<sup>65</sup>

... there were so many exemptions that a person could easily avoid paying taxes simply by claiming affiliation to a tax-exempt group (Prawiro 1998: 236).

Despite clear indications for significant tax leakage, the unregulated state of foundations was left untouched by the sweeping 1983 tax reforms, as "the reform team was clearly steered away from the taxation of foundations and cooperatives" (Heij 2007: 91), profiting cronies involved.<sup>66</sup> Similarly the President ordered that Indonesia's 200 largest taxpayers are not to be audited (ICW 2000: 14). Only tax holidays for 'foreign investments' were temporarily abolished. Yet, they were reintroduced in 1993, when Soeharto explicitly granted incentives to companies of individuals closest to him. For instance, in 1996, Director General of Taxes Fuad Bawazier facilitated between five and ten years of tax holidays benefiting Soeharto's son Hutomo "Tommy" Mandala Putra in the national car project run by his company PT Timor Putra Nasional, Soeharto's son-in-law Hashim S. Djojohadikusumo (PT Trans-Pacific Petrochemical Indotama), and members of Soeharto's inner circle of cronies and confidants, Mohamad "Bob" Hasan (PT Kiani Kertas) and Marimutu Sinivasan (PT Texmaco Perkasa Engineering, PT Polysindo Eka Perkasa) (Wells et al. 2001: 35-36). Compared to the citizens of most other countries, Indonesians have been seriously under-taxed. Most have paid no taxes at all. Only 12% of the foreign firms and 8% of domestic firms paid the maximum 45% of income tax (Gillis 1994: 17-18, 29). Only with Soeharto's fall and under IMF pressure incentives were withdrawn in 1998. Yet, by 2000 the then Director General of Taxes Machfud Siddik complained, that still "over half of the country's legislators, ministers, generals and other high-ranking government officials skipped tax payments" (JP 21.09.2001).

<sup>65</sup> "The pre-1983 tax system comprised a bewildering forty-eight rates for individuals and ten for corporations. The system consisted of a huge collection of decrees and amendments, many of which contradicted each other. To this was added a morass of exemptions and exclusions that could be applied for any number of reasons, such as promoting or supporting a particular group or activity. The system was entirely inaccessible to modern accounting practises" (Prawiro 1998: 230).

<sup>66</sup> Vatikiotis (1993: 51) estimated that in late 1989 deposits made by "foundations in state banks alone amounted to Rp 1.695 billion against Rp 755 billion held by limited liability companies".

*The discretionary room left by legislation*

In common with much of Indonesian legislation, tax laws have been characterised by many loopholes, incidences of variation, contradiction, omission and overlap. Further, the issuance of implementing rules and regulations often has been delayed or never processed at all. Interpretation of legal rules thus to a great degree depended on the individual and his/her point of view. This has led to confusion and uncertainty on the sides of both the taxpayer and the tax official.

Tax legislation in Indonesia overlaps. For example, at this moment regulation A is in effect, suddenly there occurs a case, only then are we told that suddenly regulation A has been revised with regulation B. Whereas to public knowledge regulation A is the one that is still in effect (Interview: Civil Society Representative).

This confusion in turn provided room for discretion and opportunities for tax negotiations, as a former tax official interviewed explained:

There is opportunity because legal regulations are not clear, which causes interpretations to be unclear. There are many areas, which allow this to happen. Usually, it is here where different interpretations occur and where bribery is taking place.

Complication and confusion was taken further in the paper works taxpayers and tax officials encountered when asserting and processing tax liabilities. Anecdotal evidence suggests that more than 100 different tax returns and forms of various contents, sizes and print colours circulated in the tax office, at least 40 thereof intended for the use of taxpayers. A tax official interviewed recounted that in some tax offices even forms existed, that, while officially created and printed in larger quantities, were only used few times until being forgotten. When the right form for the specific purpose had been located, difficulties did not stop, as most forms were of low quality, i.e. overly complex, inconsistent, too broad and asking for too much detail.

*Assessment, audit, payment, enforcement, reporting procedures: human contacts*

Broadly outlined, the simple tax returns management process was designed as follows: Since the 1980s, taxpayers, if their taxes were not withheld by their employer, as self-assessors were required to submit their paper tax returns to the local tax office where they have their domicile and are registered. As for businesses and professionals, these had to be accompanied with detailed statements and figures of their transactions and income situation, and proven by books of account, records and receipts.<sup>67</sup> Direct, face to face contact between taxpayers and tax officials was the rule. Tax officers personally accepted paper tax returns, stamped each page and provided taxpayers with receipts for returns submission. When a taxpayer was liable for different tax types, e.g. land and

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<sup>67</sup> Individual taxpayers were required to file their tax returns annually, while businesses and individual professionals were required to file monthly. The due date for submitting tax returns is March 31. The tax year runs from January to December. According to a survey undertaken by the World Bank and University of Indonesia's Institute for Economic and Social Research, businesses each month were required to file seven different types of tax returns, which required about 45-person days to complete (LPEM-UI 2005).

building tax in addition to income tax, the taxpayer had to deal with different tax officers at each tax office. This increased the direct contact taxpayers had with the tax administration. When the tax administration was the one to make tax assessments or when a taxpayer requested a tax refund, which by law implied an audit irrespective of the amount claimed, more direct interaction between tax officials and taxpayers was involved. Taxpayers and tax officials from different sections would come together and discuss the issues at hand.<sup>68</sup> The proceedings of these meetings were rarely recorded, as the large majority of tax officials did not have the habit of recording their work. Tax liabilities could not be paid directly at the tax office, but based on the receipt form at designated payment points, i.e. national cashier offices, state banks or post offices. Legal sanctions for late- and non-payment existed, yet were not enforced. Usually, the process stopped with the issuing of warning letters, as taxpayers and tax officials alike preferred compromise over lengthy court settlements. Data both submitted to the tax office and produced by the tax office was manually recorded by DGT staff. Formal systematic verification for accuracy or completeness of the data filed and the data recorded did not exist. Originals and hardcopies of forms and documents were stored in binders and folders in storage rooms at the taxpayer's local tax office. Access both to database and storage rooms has not been secure as most tax officials of that particular tax office were able to log-in/enter to add, retrieve or change documents and data. If these documents were needed by another section they had to be manually compiled. If the taxpayer transferred to another tax office they had to be physically transferred to the other office.

#### *Computerisation and data management*

An information technology based tax administration system with manual entry at local tax offices and subsequent monthly digital reporting from local to regional tax offices and quarterly reporting from regional offices to headquarters' master tax file has been in planning since the beginning of the 1980s (Mookherjee/Das-Gupta 1998: 423f). "No tax applications had been computerized previously, other than for gathering statistical data" (Lane/Hutabarat 1986: 1). In implementation the plan fell far short of expectations, as

initiatives were blocked, however, partly because they were seen as threatening to some groups within the tax administration. Some tax officials had long opposed installation of computerized systems because many compromised officials feared that the system would not only be accessible to but under control of agencies within the ministry other than the tax administration thereby increasing the risk that corruption might be exposed (Gillis 1994: 24).

They claimed that computerization would do little to enhance efficiency, while it would create a technical elite within the department on whom the rest would all depend. The 'tried and true' manual approach, they asserted, was more equitable in terms of work distribution. Furthermore, they argue that the manual methods might even be more accurate because, in some cases, human judgment was needed to properly process a tax return (Prawiro 1998: 233).

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<sup>68</sup> For a detailed flowchart of the Indonesian VAT Refund Process see Siregar (2005: 9).

Computers were bought, but database design and applications differed between the different types of tax service offices.<sup>69</sup> Administration and maintenance of the systems by DGT staff were limited, caused by coordination problems and the fact that different service providers had been contracted and no documentation was left with the tax administration.

Insufficient computing power, network capacity and bandwidth hindered data exchange within the office and with other offices and headquarters. Tax offices remained largely processing information independently from each other, each office maintaining their separate databases. Twenty years into the computerization, DGT's tax administration system was still far from integrated. "Not even headquarters has access to taxpayers' data from all the different regional offices" (Interview: Tax Official Middle-Level). What is more, before the 2000s tax administration reform programme started, still "most offices were not computerized" (Interview: International Organisation Representative), let alone computers fully interconnected.

DGT is far from exploiting the full potential of a computerised tax administration. It maintains a centrally computerised taxpayer master file, yet data contained tend both to be incomplete and unreliable. Data-mining capabilities and analytical tools for risk-based management and operational decision-making have been very limited.

In particular, DGT does not yet have a reliable system to analyze compliance risks and target its audit and enforcement measures to high-risk areas and potential evaders; the taxpayers registry is unreliable and there is no control of filing and payment compliance due to errors in taxpayer account management and incomplete account data (World Bank 2008b: 1).

In fact, an international organization representative described "garbage in the system" as a major weakness: "... it is a mess. ... You ask for information in the DGT and depending on how you ask it, you will get a different number on a different day".

The design of business processes made tax collection a complicated undertaking. Compliance costs for taxpayers were high. Paying tax liabilities costs money, time and patience. The distance between a taxpayer's domicile and his tax office, the abundance of rules and regulations, the requirement to visit different tax offices and tax officials of various sections, insufficient transparency and inconvenient opening hours of tax offices and designated payment points, in addition to the more direct costs related to the tax liability had to be considered in calculating the real costs of paying taxes. Complicated business processes also implied high administrative costs for the tax authority. DGT's budget was spent inefficiently.

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<sup>69</sup> In the 1980s, the NPCPS (New Payment Controls System, *Aplikasi Pengawasan Pembayaran*) was developed, since 1995 district tax service offices used a system called SIP (Tax Information System, *Sistem Informasi Perpajakan*), while land and building tax offices used a system called SISMOP (System for the Management of Taxpayers' Information, *Sistem Manajemen Informasi Objek Pajak*).

*Tax officials and taxpayers: mutual distrust and negotiations*

Relations between tax officials and taxpayers have not been smooth, since neither party has trusted the other. Tax officials suspected taxpayers to be inherently dishonest: "In case corruption takes place, the initiative more often has been taken by the taxpayers" (FGD: Tax Officials).<sup>70</sup> Taxpayers suspected tax officials to abuse their discretion harassing and extorting taxpayers for private gain: "When there is a fault, it is always us that are wrong and always the officials that are right" (FGD: Business Representatives). Tax officials saw taxpayers as cheaters, while taxpayers saw themselves as victims as it was the tax administration which exercised monopoly power. Tax officials were perceived, and allegedly many also perceived themselves, as superior to the taxpayer.

An atmosphere of cynicism developed, where honest taxpayers were demoralised: "If businesses want to pay fairly, based on the regulations, the people in the customs and tax suggest that they don't. ... So even the businesses with good intentions to pay, they are led astray" (Interview: Politician) and honest tax officials have been ashamed of working for the Directorate General of Taxes:

Before 2002, when I was asked whether I am a tax officer or not, I said that I am employed with the Department of Finance or the Department of Justice. I didn't say that I am a tax officer. Why? Because I wasn't proud yet of being a tax officer (Interview: Tax Official Middle Level).

Tax collection was complicated and arbitrary in nature, corresponding with the popular Indonesian notions that 'everything has a price' and 'everything can be arranged'. Taxation was a matter of negotiation, where the tax official had his assigned tax target<sup>71</sup>, and the taxpayer the maximum amount of taxes he was (quasi-voluntarily) willing to pay in mind. Direct collusion between taxpayers, sometimes with the assistance of private tax consultants who had previously worked or even were still working with the DGT, and tax officials has been common practise, as reported by the great majority of interviewees. The way to negotiation mostly has either been directly taken by the taxpayer via grossly underreporting their income or been introduced by the tax officer via an arbitrary assessment provoking taxpayer's objection. VAT refunds here play a particularly important role, as by law they trigger automatic audit.

An accounting employee at a private firm stated that he experienced tax officials to come up to his office at special times of the year, e.g. around *Lebaran*, the end of the Islamic fasting month, to ask for holiday allowances [*THR*, *tunjangan hari raya*], to request contributions [*sumbangan*] towards the tax officer's child's marriage ceremony, or ask for an entertainment fee [*uang entertainment*]. Either one paid this allowance or one's accounting was put under close scrutiny (ICW 2000: 10, 13). A civil society representative interviewed described the direct collusion between taxpayers and tax

<sup>70</sup> In the late 1970s, the DGT estimated that more than 95% of income tax returns and more than 85% of corporate taxes of private entities contained false information (Avenarius 1981: 182).

<sup>71</sup> The Indonesian taxation system operates by "tax collection targets", whereby the national tax revenue target is negotiated annually by government and national parliament, in particular DPR Commission XI on financial affairs, after which the target is determined in the draft state budget (*RAPBN*) and then distributed from the top down to local tax offices nationwide.

officers he observed as conspiracy [*kongkalikong*]: "There is something like an agreement between tax officers and enterprises. Ok, what is important is that you pay this much taxes each month, the rest becomes a kickback, manipulation and so forth". Describing his experiences with the DGT, a businessman interviewed said that,

Very often what the tax officer is doing is to come out with a report that is ridiculous and then you come in and have to argue with him and then they come down and settle to do something. ...It did not matter what the regulation was, how much money you do make.

Negotiation and compromise making, commonly benefited both the taxpayer and the tax officials but inflicted loss to the state. What happened, simplified was that "someone who was supposed to pay 100, finally pays 40 to the government treasury and 20 to the tax officer" (Interview: Other Government Official, cf. Simanjuntak 1979: 123).

Asked about the process how he reached settlements with tax officials, the businessman elaborated how the available space can be used:

You cannot change the tax rates and you cannot say that you actually need to have a decision if you haven't had an audit, even if you have very good relations. But for example, if I had a big chunk of non-deductible items I can make them deductible by having a good friend. It's not as fluent, I don't have to do anything, I just do a handshake. That doesn't work. But if you have a problem in your bookkeeping and you know about it, you go up and say, 'You know, maybe I have some problems, maybe we can just forget about that.' It's more on that level, it doesn't mean that you can go up and say that you don't want to pay anything. Also, even if you have relations. That means that you have to guard his targets as well. It works two ways. I would say, it's somewhere in-between. The system is there and the system is being used, you cannot override the system, you can maybe make the data that's input into the system a little bit more favourable to you. But if you have a company and you make a lot of money, you will end up having to pay taxes. All your connections in the world can't because there is media, KPK, ... If I have a bookkeeping that is not 100% perfect, I can hide away. So, if I have some dodgy invoices and so on, I can get them through that way.

Most taxpayers who, in casual private conversation with the author, were asked to describe their experiences with the DGT repeated similar stories. Tax officials themselves also admitted that before the 2000s reforms indeed many of them regarded tax negotiations as something normal and reasonable [*lumrah dan wajar*]. When taxpayers gave them something, in cash or kind, it was regarded as a 'token of respect' [*tanda hormat*] (see Budiharjo et al. 2009).

Taxpayers allegedly were not treated equally. Anecdotal evidence suggests that similar tax cases did not guarantee the determination of similar tax liabilities; instead according to a taxpayer's personal standing, personal connections and negotiation skills, very different amounts were finally to be paid/refunded. Another businessman interviewed pointed out:

Your personal approach is extremely important. If you are a golf buddy with a head of office [*kepala kantor*], of course, then you will get rid of a lot of problems. Definitely a lot depends on personal contacts, not in the sense that you have to be friends, but the way that you present yourself to the tax office is extremely important. Still very much depends on perception, if you are perceived as a well-organised and a nice person, then they treat you differently, than if you are a crook.



In summary, Table 4.2 describes frequent types of integrity violations in tax administration, common mechanisms, stakeholders and the related popular Indonesian expressions.

TABLE 4.2: Integrity Violations in Taxation and related Indonesian Terms

Types		Mechanisms	Stakeholders
Tax evasion			
<i>rekening liar</i>	Tax reductions	Taxable income/transactions that are intentionally not reported/ under-/ or overreported in accounts.  Several ledgers are used, including one for taxation purposes that may show a deficit/overpayment.	Taxpayers
Tax collusion			
<i>tawar-menawar</i> <i>kongkalikong</i> <i>uang damai</i>	Tax reductions	Taxpayer and tax official negotiate tax liabilities.	Taxpayers Tax officials
<i>uang suap</i> <i>komisi</i>	Tax exemptions	Taxpayer is not registered in the tax registers, but pays a lower tax 'privately' to tax collectors.  Taxpayer and tax official negotiate payments to avoid fines and penalties.	Taxpayers Tax officials Politicians
<i>konsultasi gelap</i> <i>sekongkolan</i> <i>makelar pajak</i>	Tax reductions Tax exemptions Special treatment	Taxpayer and tax official negotiate tax liabilities and/or services via a third-person.	Taxpayers Tax officials Intermediaries
<i>faktur pajak fiktif</i> <i>jaringan pajak</i>	VAT fraud	Falsified claims for VAT refunds that occur with the help of collaborators.	Taxpayers Tax officials Fictitious companies
Tax corruption			
<i>pungli</i> <i>pungutan liar</i> <i>uang administrasi</i> <i>sumbangan</i> <i>uang</i> <i>entertainment</i>	Extortion	Asking for payments for services which should be free of charge.	Tax officials
<i>uang pelicin</i> <i>uang semir</i>	Extortion	Payments for faster services/procedures.	Tax officials Taxpayers
<i>pemerasan</i>	Large-scale extortion	Taking advantage of taxpayers' incomplete knowledge of tax legislation, tax officials threaten taxpayers to pay above rates.	Tax officials
<i>kebocoran pajak</i>	Embezzlement of collected revenue	Tax officials steal money collected.	Tax officials Bank employees

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<i>uang lelah</i>	Fraud	Falsifying tax receipts.	Tax officials Authorized printing houses
<i>suap</i>	Corrupt inspectors/ auditors	Inefficient and/or corrupt internal auditing.	Tax officials External parties

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Source: Author's compilation, partly adapted from Fjeldstad (2005: 6) and ICW (2000: 16-17).

### *"Revenue-sharing"*

During New Order, corruption and collusion within the DGT were remarkably organised. Those highest up in hierarchy largely determined which direction the whole office under their supervision would take. Senior officials with good morale accepted taxpayers' 'thank-you-money' [*uang terimakasih*] for services provided, while senior officials with bad morale demanded 'commissions' [*uang komisi*] for services rendered (Interview: Tax Official Management Level). Accordingly, senior officials either tolerated engagement in tax manipulations or actively encouraged it. Subordinates commonly obeyed instructions from their superiors, as accountability tended to apply internally only. "There are only two options for tax office officials: you either join the club of corruptors and get rich, or you stay honest and spend your entire career in the tax office's library" (JP 10.12.2004).

Three general rules seem to have applied: 1) the higher the amount to be negotiated the higher the negotiating partner's position in DGT hierarchy had to be, 2) rulings made by a tax official could always be overruled by a superior tax official, 3) the higher a tax official in hierarchy, the higher the thank-you money/commission involved. Most tax officials in some way were involved in illicit practises as revenue-sharing was the rule. Sharing took place from the bottom to the top and from the top to the bottom. According to a middle-level Jakarta-based tax official:

... illegally-collected funds are normally distributed within the tax office with the tax collector getting 25%, his or her coordinator 15%, the section head 25% and the tax office head 30%. The tax office head would later distribute the money to the higher-ranking officials, including the Directorate General of Taxation's top officials (JP 10.12.2004).

There is evidence, that parts of the profits were used as 'tactical funds' [*dana taktis*], that is funds that were kept outside the official budget and therewith outside of state control. Allegedly these were used to finance special operational costs, e.g. office supplies, salaries of temporary staff or entertainment costs, obtain political parties' and

politicians' support, as well as to pay off state audit and investigation authorities (Siregar 2005: 14; K 14.05.2010).<sup>72</sup>

Analysis of design, implementation and execution of the DGT's core business processes, registration, assessment, audit, payment, enforcement, and reporting, indicates that space for tax avoidance, tax evasion, collusion of taxpayers and tax officials, and tax corruption was created in the past and since has been kept open deliberately. Both in data collection and processing, the DGT in many ways deviated from international standards. Stakeholders affected identified numerous problems. The implications are deliberate inefficiency accounting for a low tax ratio, wide scope for reforms, and the challenge to overcome deeply entrenched practices for reformers.

#### 4.3.4 Administrative Accountability

Indonesians described the DGT as a heaven for officials on the take, a den of thieves [*sarang penyamun*], a nest of corruption [*sarang korupsi*]; they perceived tax officials as having the license to extort, as haunting ghosts [*momok*], chasing within the zoo [*berburu di kebun binatang*] and members of the "in the end all is about money" fraction [*uud atau ujung-ujung dhuit*]. Frequent rumours on cases of corruption and collusion fuelled these descriptions. Also, high-ranking individuals who had close insights into the DGT's day-to-day operations perceived such incidences.

For example, Gillis (1994: 17), who in the 1980s acted as HIID Project Director to Indonesia's fiscal reform project, described that opportunities offered by weak business processes were "rarely unutilized". Radius Prawiro (1998: 231), who held ministerial economic portfolios for almost three decades (1965-1993), made a similar point when he stated that "It was well known that a job as a tax collector was one of the surest roads to riches in the government bureaucracy". These perceptions persisted following the demise of President Soeharto, as public opinion surveys indicate. Private individuals, business representatives and public officials continued to perceive the tax authority among Indonesia's most corrupt and inefficient public organizations.

#### *Extend of corruption and collusion*

In 2001, the National Survey of Corruption in Indonesia asked respondents to rank a list of 35 public institutions in terms of integrity.<sup>73</sup> The tax authority was ranked the fifth

<sup>72</sup> In 2008, the Supreme Audit Board uncovered illicit accounts related to the Department of Finance (VN 22.12.2008). While no disaggregated data has been released, it may be assumed that some accounts belonged to the DGT. Further, the career paths of several tax officials from the DGT to other departments, agencies and to politics can be seen in this light. Former Director General Fuad Bawazier took up influential positions in PAN (*Partai Amanat Nasional*) and later Hanura (*Partai Hati Nurani Rakyat*) following the demise of the New Order regime. Bawazier was widely believed to have been a major source of party funding (Hadiz/Robison 2004: 232). A further case has been Muhammad Misbakhun, who was alleged to have amassed a small fortune during his career at the DGT before joining the PKS (*Partai Keadilan Sejahtera*) (JG 18.08.2011; 27.08.2011).

<sup>73</sup> The survey interviewed 650 public officials, 400 business enterprise managers, and 1,250 ordinary Indonesian citizens regarding their perceptions of corruption and actual experiences with corruption (Partnership for Governance Reform in Indonesia 2001: vi).

least honest institution, after the traffic police, customs authority, judiciary and the office of the prosecutor, with ratings of 2.9 from public officials, 2.4 from households and 2.2 from business enterprises on a scale ranging from 1 (very corrupt) to 5 (very honest). Based on public officials' self-report about 54% of Ministry of Finance employees were perceived to receive unofficial payments. Within DGT it might have been even more. There is wide belief, that in an institution such as the DGT, which has such lucrative sources at its disposal, it "is almost impossible to be a 100% 'clean official'" (JP 12.05.2010). Finance Minister Sri Mulyani Indrawati (2005-2010)

herself has often complained about the extreme difficulty in finding tax officials with completely clean records or without skeletons in their closets for supervisory roles because of the extreme tolerance for corruption prevalent during the pre-reform era (JP 06.04.2010b).

Taxpayers maintained that many tax officials' lifestyle was far better than realistically possible with the official salaries and compensations they received (JP 19.04.2010; MT 13.06.2005a). Business respondents stated that the minimum bribe they paid tax officials at encounter was about Rp 2.500, the maximum Rp 500 million, the mean was calculated as about Rp 9.7 million (Partnership 2001: vii, 13, 15). According to the Global Competitiveness Index it has been very common for firms to "give irregular extra payments or bribes connected with annual tax payments". In 2001, Indonesia in this category was ranked 71<sup>st</sup> out of 75 countries, in 2002, 76<sup>ed</sup> out of 80 countries assessed (World Economic Forum 2001: 406; 2002: 615). In 2005, the World Bank and the University of Indonesia reported that 57% of their survey respondents admitted that they made informal payments to tax officials and negotiated to obtain VAT refunds (LPEM-UI 2005). Taxation has been perceived as one of the major impediments for doing business in Indonesia (see ADB/World Bank 2003).

Due to its illicit nature, detailed figures on the loss inflicted on government revenue are unknown. Nevertheless, both national and international stakeholders agree that the amount lost potentially is very large. Within the last decade, a number of "leakage guess-timates", based on different comparative reasoning, circulated in public debate. The Indonesian journal Gatra (13.07.2001) wrote that "based on data from DG Taxes between the years 1991 to 2000 government experienced a potential loss of up to Rp 130 billion". This is likely to be an underestimate, as the figure seems to contain only those known tax arrears where the tax authority assumed that recovery could be realised. Indonesian economists Kwik Kian Gie and Faisal Basri estimated losses of Rp 100 billion resp. Rp 40 billion annually. Director-General of Taxes Hadi Purnomo maintained that what Kwik Kian Gie and Basri meant was the leakage potential [*potensi kerugian*] and that DGT in this regard would consider even a larger potential of Rp 679 billion, or about 2% of the GDP. These figures however would not equal the situation on the ground (MT 13.06.2005b). Transparency International Indonesia chose yet another approach. They estimated that tax negotiations cause a loss of 40 to 60% of potential tax revenues (BI 08.12.2004).

### *Internal and external accountability mechanisms*

With regard to the civil service, a World Bank mission pointedly remarked: "Indonesia's accountability framework is sound on paper. ... But accountability breaks down in implementation" (World Bank 2003a: 99ff). These findings held true for the DGT. DGT's operations were carried out under a veil of secrecy and disregard. Effective internal and external controls have not been in existence.

Internally, corrupt and colluding tax officials and taxpayers had little to fear. Indonesia's civil service culture, the preference for harmony over conflict [*sistem damai*] and the prevailing tradition of hesitancy [*ewuh pakewuh*] prevented clean tax officials to report, even more to investigate and sanction deviations. As a Ministry of Finance senior staff member explained, "many officials cannot take necessary actions after knowing that their family, friends, superiors, former superiors or even prominent figures are behind the tax crime or other actions against the law" (JP 12.05.2010; cf. Lerche 1980: 48). Tax officials rather closed their eyes and adopted a "just leave it" [*biar-sajalah*] attitude. Thus, visits from headquarters to regional offices and from regional offices to local offices had more a ceremonial character. Visitors were shown around and catered for; formal discussions seldom went further than discussing tax target issues.

A specialised internal audit and investigation unit for and at the DGT did not exist. Internal audits fell into the shared responsibility of the State Development Audit Agency [*BPKP, Badan Pengawasan Keuangan dan Pembangunan*] and the Ministry of Finance's Inspectorate General [*IG, inspektorat jenderal*]. However, BPKP inspectors lacked relevant competences and qualifications, and IG inspectors lacked independence and manpower. Many inspectors were described as complacent and open to bribery. What they investigated and whether anything was found is unknown, as reports were not made public. In implementation internal control seemed nearly absent.

Externally, corrupt and colluding tax officials and taxpayers also had little to fear. Soeharto had turned Indonesia's Supreme Audit Board [*BPK, Badan Pengawasan Keuangan*] into an agency for the 'post-approval and legitimization' of government policies. A limited budget, insufficient human resources, and limited competences, curbed its operations. Where the BPK was allowed to audit, everything was "audited"; no risk-based priorities were proactively set. Audits remained on the surface. BPK was essentially accountable to the President. Its reports, via the State Secretariat, first had to be consulted with Soeharto before they were passed on to Parliament (cf. Dwiputrianti 2011).

Following democratisation, BPK's mandate was expanded. Yet, it continued to face limitations in delivering on its expanded remit.<sup>74</sup> Article 34 (1) of Indonesia's highest-ranking law on taxation stipulates that "An official shall be prohibited to give an

<sup>74</sup> By 2006, the BPK to audit all public institutions at all levels of government had offices only in 16 provinces nationwide and about 3.500 employees. In comparison BPKP, whose mandate compared to BPK was significantly reduced, had offices in 26 provinces and about 6.800 employees (World Bank 2007a: 107).

unauthorized party any information learned or provided to that official by a taxpayer in the course of his duties or work in implementing the provision of the tax law". This prohibition from disclosing taxpayers' confidentiality meant that the BPK has hardly been able to investigate DGT's performance or investigate indications of misconduct committed by tax officials or taxpayers. Cynically the BPK's Chairman Anwar Nasution (2004-2009) commented: "Only the Directorate General of Taxes and God know the tax information" (DF 28.11.2006).

Without effective controls and amidst serious deficiencies in Indonesia's justice sector, the long and comprehensive catalogue of disciplinary measures and sanctions, for taxpayers ranging from written warnings or fines to imprisonment, for tax officials ranging from verbal warnings or demotion to dismissal from service, had little meaning. As Smith and Smith (1971: 782f) had already observed "meaningful sanctions are almost unknown in Indonesian tax administration". Tax officials and taxpayers have acted within an environment of impunity. According to Lerche (1978: 203), from the year 1960 to 1980 "no tax violation was taken to the courts, let alone someone sent to prison". From 1981 to 2000 only 41 cases of tax violations were investigated, a DGT study discovered (Wiranto 2001). In 2000, a public officials' survey confirmed the reluctance on the part of senior officials to punish poor performance and corruption. "When asked if staff in their organizations were disciplined for corruption, only 5% reported that they were, while another 8% reported being disciplined for embezzlement. The most common reason for being disciplined was insubordination" (World Bank 2003a: 98). Civil servants found to misuse their powers were transferred to another position or removed from office. Rarely were they prosecuted or stripped of their civil servant status and salary.

Small taxpayers could do little against tax officials when they felt treated unfairly. Taxpayers' knowledge on what would have been the appropriate treatment has been insufficient and unreliable. Access to tax legislation has been difficult and required substantial efforts from taxpayers. The tax office's rules and procedures for specific services, the fees and charges taxpayers were required to pay, and the standards taxpayers could expect were rarely made available to the wider public.

Taxpayers' objections were first dealt with at the DGT. In those cases, where taxpayers and the director general were unable to reach an agreement, the tax court [*pengadilan pajak*] was the last instance one could turn to. For many taxpayers related costs, however, presented a significant obstacle. The tax court only accepted cases when 50% of the liability had been paid, the court's only seat nationwide was in Jakarta which implied high travel costs, tax consultants and/or case brokers [*markus/makelar kasus*] had to be hired, and long delays were to be expected. Furthermore, the independence of the court was not guaranteed. Under the authority of the ministry of finance and located on ministry of finance premises, the tax court lacked autonomy. The large majority of judges were recruited from the DGT, others came from DGCE; only few had a legal background. Lack of transparency was another issue. Detailed public schedules of hearings arranged were unavailable, observation of hearings, while officially open to the

public, were possible only with the consent of all judges, copies of proceedings and verdicts of hearings were inaccessible. Taxpayers complained that they “often became confused with differing court decisions, while the issue disputed and the other circumstances were precisely the same to the appeals filed in previous years” (Masyarakat Transparansi Indonesia 2010: 32). Allegations were frequently voiced that the Tax Court itself was engaged in corruption cases.

Under these circumstances, tax reforms constitute a particular challenge.

## 4.4 Process of Reform

### 4.4.1 Domestic Actor Constellations

Domestic actors' support for the 2000s tax administration reforms was uneven. While all stakeholders publically emphasized their full support, the actual reform process and the observable political manoeuvring around it indicate that reforms in fact were pushed by few key reformers and confronted with well-entrenched vested interests.

Technocrat Finance Minister Sri Mulyani Indrawati (SMI) has been widely perceived as the reforms' architect. With a flawless track record, she had the reputation of being incorruptible. Prior to her appointment in 12/2005, Sri Mulyani held positions as Professor of Economics at University of Indonesia and IMF Executive Director for East Asia and the Pacific. This gave her a clear idea of reform opportunities.<sup>75</sup>

Based on the strategic programme, mission and vision outlined by her predecessors, technocrat Boediono (08/2001-10/2004), who became Coordinating Minister for the Economy (2005-2009) and has been Indonesia's Vice-President since 2009, and career bureaucrat Jusuf Anwar (10/2004-12/2005), Sri Mulyani told her staff that she expected them to achieve what was outlined. She claimed to prefer leading by example and motivation, to instill a sense of ownership among her staff (SMI in IfSS 2009b). Throughout her term she gained the image of an iron lady for her strong character, no longer accepting long-entrenched practises and focused upon institutionalising a more transparent and merit-based bureaucracy. She gained respect and praise from both within and outside the DGT for her leadership, dedication and commitment to reform.<sup>76</sup>

One of Sri Mulyani's first acts upon assuming office was the removal of Hadi Poernomo, a career tax official who had been the Director General of Taxes since 2001. According to Sri Mulyani, his dismissal was a symbolic act to show the public that she is a reformer, rather than a decision made based on his ability to raise revenues. Hadi Poernomo, a PDI-P loyalist, was known to have “influence in the Parliament, in the Cabinet and even to the president. ... the public just did not trust [him]” (SMI in IfSS

<sup>75</sup> Rumour has it that at the time of cabinet deliberations multiple political parties, notably Golkar, lobbied the President not to appoint staunch Sri Mulyani Indrawati Minister of Finance, but someone gentler.

<sup>76</sup> Among others, in 2006, Emerging Markets named Sri Mulyani as the ‘Best Asian Finance Minister’, in 2007, Globe Asia named her ‘Most Influential Woman in Indonesia’, in 2008 and 2009, Forbes included her in their list of the ‘Most Powerful Women Worldwide’.

2009b; cf. MT 21.06.2010a). Many Indonesians perceived the DGT under his leadership as deeply corrupt.<sup>77</sup>

To turn things around, Sri Mulyani appointed Darmin Nasution, Chairman of the Capital Market and Financial Institution Supervisory Agency [*Bapepam & LK*], Director General of Taxes. Darmin, who had been close to Sri Mulyani since both lectured at the University of Indonesia, had the reputation of being resolute, courageous and clean. As an outsider, Darmin did not have many personal relations within the DGT, which made it easier to challenge the tax authority's status quo and initiate reforms. In hindsight, Darmin was widely perceived as the reforms' wheel, driving the reform process in the direction discussed with the Finance Minister. By July 2009, Darmin retired from DGT and transferred to (graft-infested) Bank Indonesia as its Senior Deputy Governor.

DGT insider Mochammad Tjiptardjo succeeded Darmin Nasution. Previously, Tjiptardjo as Director of Investigation and Intelligence led tax fraud investigations involving several powerful businessmen.<sup>78</sup> While he had some achievements and had worked closely with Darmin, rumours maintain that Tjiptardjo was not Sri Mulyani's and Darmin Nasution's first choice (MT 03.08.2009). During his inauguration, Sri Mulyani explained that Tjiptardjo had not been chosen for his personal achievements, but as a representative of a generation of senior, mostly high-ranking tax officials, whose time had come to demonstrate their commitment to change (JP 29.07.2009).<sup>79</sup>

As a technocrat, the Finance Minister depended on the President's support. Susilo Bambang Yudhoyono provided Sri Mulyani with the backing needed, if at times too cautious and indecisive. In supporting her, the directly elected President may have been motivated by the desire to maintain his image as a clean, reformist leader by accomplishing campaign promises in order to safeguard his own long-term popularity. Regularly Sri Mulyani personally consulted Yudhoyono and obtained his blessing.<sup>80</sup> At different occasions the President publicly declared his support for public administration and financial management reforms, and pledged his government's intention to roll-out successful programmes nationwide. Yet, it appeared that he did not show a lot of interest in implementation details. Yudhoyono may have realised that beyond rhetoric, at least in the medium-term, it would hardly be politically feasible to adopt the example of the Ministry of Finance and reform the entire Indonesian public administration.

<sup>77</sup> Hadi Poernomo later came under suspicion as a KPK comparison of his statements of wealth revealed that his net-worth not only doubled during his time as Director General of Taxes, but also 98% of his wealth was listed as grants [*hibah*] from family and friends (MT 21.06.2010b; JG 21.10.2010). Indonesia Corruption Watch calculated that the largest proportion of 'gifts' Hadi received was when he was tax examiner in Jakarta from 1987-1993.

<sup>78</sup> These include Sukanto Tanoto (PT Asian Agri) and Aburizal Bakrie (PT Kaltim Prima Coal).

<sup>79</sup> Many doubt the integrity of senior officials, but it is impossible to lift young career civil servants to the post, no matter how good they are, as Indonesia's civil service regulations require a minimum time of service before someone can be promoted to a high structural position.

<sup>80</sup> This seems to have been exceptional. Many ministers communicate primarily through the coordinating ministers and the cabinet secretary, as they are not granted personal meetings with the president (Fealy 2011: 335).



The desire to be associated with the ideas of reform and development while fearing potential risks to vested interests left politicians in a dilemma. Evidence suggests that the legislators' adopted way out has been to permit reforms in general, but limit their scope to elite-defined boundaries. Put bluntly, reforms are welcome as long as the expected benefits outweigh the perceived costs. In anticipation of declining revenues and in light of Indonesia's preference for sovereignty and self-determination, DPR early on approved substantial budgetary means for tax administration reforms, which allowed for finance officials' salaries to be raised and co-financing the modernisation of tax offices. Yet, the passage of the Ministry of Finance's tax reform package of three bills, which experts deemed crucial for addressing the tax administration's greatest weaknesses, took more than four years to be completed.<sup>81</sup> That withstanding, until late 2009, the public perceived the DPR as overall supportive to DGT reforms.

Subsequent episodes of political manoeuvring by political parties and members of parliament tarnished this impression however. In October 2009, parliament and BPK members, who themselves were all chosen by DPR (JP 16.12.2009), elected the questionable former Director General of Taxation Hadi Poernomo Chairman of the Supreme Audit Board. In November 2009, legislators from several political parties launched a parliamentary inquiry into alleged irregularities in the bailout of Bank Century during the global financial crisis (see McLeod 2010a). Reform-oriented Sri Mulyani Indrawati and Boediono, who had initiated the government bailout, soon became the inquiry's main targets. Parliament questioned the legitimacy of the bailout and the roles played by Sri Mulyani and Boediono. Extensive media coverage, "which had less to do with well-balanced analyses than with well-staged attacks against Cabinet members who challenged vested interests" (von Luebke 2010: 84), accompanied long-winded cross-examinations and parliamentary hearings. In March 2010, despite the special inquiry committee's inability to present any evidence of illegality in relation to the bailout, a majority of DPR members concluded that the bailout constituted "an abuse of power by officials from the monetary and fiscal authorities ... that could qualify as a suspected act of corruption" (K 04.06.2010).

Finance Ministry insiders suspected that the inquiry was a concerted attempt to unseat both Sri Mulyani and Boediono. A wide-range of political analysts shared this opinion. They saw three main potential motives behind the inquiry: revenge against the Finance Minister's staunch and unfavourable policies, fear of tycoons and their cronies of being investigated and prosecuted for tax manipulations, and expectations of financial gains with a weaker finance minister. Politicians involved denied any such aims. Yet, while

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<sup>81</sup> The tax reform package contained laws on general rules and procedures of taxation, income tax, and VAT and luxury tax. A first bill on general rules and procedures was submitted in 2003. Within the deliberation process the draft has been changed, e.g. a paragraph stating that fraudulent tax officers should be sanctioned got lost. Nobody knew who had authored these changes. Most likely brokers hired by vested interests had been involved (JP 12.09.2009). A second bill, reducing tax officials' excessive power, by including the possibility to sanction tax officers, and giving taxpayers greater protection against unscrupulous officials, by incorporating the business community's proposals, such as a new provision for complaint mechanisms, was submitted only in 2006, after Sri Mulyani Indrawati's appointment (MT 11.06.2007).

Boediono, as directly elected vice-president, remained in office, Sri Mulyani resigned in the aftermath of the inquiry in May 2010. She accepted an appointment as Managing Director of the World Bank Group.<sup>82</sup>

Why Sri Mulyani made this move remains unclear. Speculations abound, that her resignation was the result of back-room negotiations between the President and powerful vested interests whose support the President needed for political survival.<sup>83</sup> The one tycoon singled out for potential involvement was Aburizal Bakrie, Indonesia's richest man with a reported net worth of US\$ 5.4 billion in 2007 (F 13.12.2007). Other suspects included the tycoons Sukanto Tanoto (PT Asian Agri), Gunawan Jusuf (PT Makindo) and Paulus Tumewu (PT Ramayana), who had been alleged of tax fraud in recent years (JP 22.11.2010).

At the time of the bailout inquiry, Bakrie served as the Chairman of the second largest party in Yudhoyono's coalition, Golkar. Bakrie often was referred to as the government's "paymaster". Many believe, that Bakrie, who was the Indonesian Chamber of Commerce's president (1994-2004), not only endorsed Yudhoyono's presidential candidacy in 2004 and 2009, but also contributed generously to his campaigns, in terms of financial assistance, personal influence taking on leading figures and media support. Further, Bakrie was suspected of being an important financier of Golkar and other parties in support of the Yudhoyono administration (Mietzner 2007: 256; von Luebke 2010: 91). Probably, in exchange for his support Aburizal Bakrie was appointed Coordinating Minister for the Economy (2004-2005), and Coordinating Minister for People's Welfare (2005-2009). Aburizal Bakrie "is widely regarded as a key obstacle to democratic reform in Indonesia" (Tomsa 2010: 314), yet despite public demands for his removal has managed to stay in office.<sup>84</sup>

Speculations about Bakrie's involvement were also fuelled by: the leakage of a long-standing feud between Sri Mulyani and Bakrie (MT 14.12.2009), the President's failure to publicly make any attempt to dissuade the Finance Minister from resigning, and statements Sri Mulyani gave international media following her resignation, warning against reforms being hijacked by a small group of very influential political entrepreneurs. Among others, she told the Financial Times (26.05.2010)

that there were a small but determined group who were attempting to co-opt Indonesia's political and economy system to amass influence and money ahead of the presidential election in 2014 ....

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<sup>82</sup> As managing director, Sri Mulyani Indrawati supervises the regions of East Asia and the Pacific, Latin America and Caribbean, the Middle East and North Africa, as well as the Information Systems Group.

<sup>83</sup> There were also allegations that Bank Century funds were channelled to Yudhoyono's re-election campaign and private-sector allies (Aditjondro 2009). In 2011, based on secret US diplomatic cables revealed by Wiki leaks, Yudhoyono was suspected of personal intervention "to influence prosecutors and judges to protect corrupt political figures and pressure their adversaries" (ABCN 14.03.2011). Yudhoyono strenuously denied these allegations.

<sup>84</sup> In recent years, Bakrie lost much of his wealth. In 2011, he ranked only 30<sup>th</sup> with a net-worth of US\$ 890 million (F 23.11.2011).

Personal attacks against her by a small cabal of political and business figures forced her to step down.<sup>85</sup>

Nevertheless, Sri Mulyani denied that the President ordered her to resign.

While Yudhoyono had made several public statements to encourage the prosecution of tax evaders and warned against the danger of collusion between politicians and businessmen earlier, soon after Sri Mulyani's resignation, Bakrie's influence grew. Yudhoyono established a joint secretariat to improve the coordination and communication among coalition parties and appointed Aburizal Bakrie its executive chairman. Many Indonesians believe that the secretariat has formed a new forum for back-room deal making. Once more this strategy has underlined the President's preference for political stability over reforms. Further it may suggest that Bakrie's financial resources were indispensable for Yudhoyono's government.<sup>86</sup>

Agus Martowardojo succeeded Sri Mulyani as finance minister. The career-banker had proven his firm attitude and managerial skills when, as its CEO, he reformed the country's largest bank, Bank Mandiri. He was believed to be capable of continuing the reforms initiated. Agus initially retained Tjiptardjo, yet in January 2011, five months before his due retirement, "honourably replaced" him with an outsider, Fuad Rahmany. Tjiptardjo's dismissal had been preceded by a months-long controversy between the Parliament's Working Committee on Taxation, which requested to lay-off Tjiptardjo for non-cooperation and weak performance, and the Finance Minister, who did not want to give in to DPR pressure.

In addition the committee requested the 'non-activation' of the Director of Investigation and Intelligence, Pontas Pane and of former head of North Sumatra Regional Tax Office I, Ramram Brahmana. Legislators suspected tax officials' involvement in tax embezzlement from a company linked to PT Asian Agri (JP 08.05.2010). Rumours spread that these requests for 'non-activation' in fact were targeted at ending the investigations into related tax fraud cases (MT 07.06.2010). Previously, PT Asian Agri had won a libel suit against Tempo magazine, which had published an investigative report about the company's alleged involvement in tax evasion (JP 10.09.2008).

By mid-2011, Golkar requested the dismissal of Finance Minister Martowardojo. Yet, upon Vice-President Boediono's insistence, President Yudhoyono decided to retain Martowardojo. While Golkar accepted the President's decision, they threatened to give the Finance Minister a hard time (JP 20.10.2011).

In the early 2000s, DGT staff was hardly willing to reform. Senior management half-heartedly introduced what the IMF had requested. Few efforts were made to gain

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<sup>85</sup> Sri Mulyani made similar public statements warning of 'losers' for a variety of reasons trying to impede reform two years earlier already (Indrawati 2008: 14).

<sup>86</sup> A comparable episode occurred in 2006, when Yudhoyono established a presidential work unit for reform programme management (UKP3R). Vice-President Yusuf Kalla and other senior Golkar figures heavily criticised the unit and questioned its legality. In response, Yudhoyono allowed it to lapse. It was only revived and later renamed (UKP4) during his second presidential term.

sustained support within the tax office. This situation changed with Sri Mulyani. Since, tax officials have been split into three main groups.

First, a small set of senior management staff, mostly high-ranking, based in Jakarta actively promoting reforms at the tax authority. These individuals are said to have been handpicked by the Director General of Taxes and the Minister of Finance, following in-depth interviews on the candidates' personal ideas about and commitment to tax administration reforms. Mutual trust seems to have been crucial, as the author's analysis of DGT Echelon II rotation over a period of three years indicated: Those positions directly related with reform objectives were rotated most frequently.<sup>87</sup>

Second, a large group of staff from all seniority levels supporting reforms or at least not showing open resistance to reform. Risk-averse, subservient to the Indonesian bureaucracy's rigid hierarchy and adherent to the 'as long as the boss is happy' [*ABS, AIS, asal bapak/ibu senang*] principle, these tax officials initially tended to be worried about change, yet quietly accepted and tried to implement reforms introduced by their superiors. Perceived benefits of reform later motivated many individuals to fully support further changes.

Third, a small group of staff from all seniority levels resisting reforms. While some individuals not actively tried to undermine reform efforts, for various reasons they, as far as possible, refused to adapt their way of working to new circumstances, while willingly partaking in any personal benefits of reform. The Director of Business Process Transformation explained that resisters "don't work wholeheartedly in the office ... we detect that from the standards of production" (Robert Pakpahan in IfSS 2009a).<sup>88</sup> Others a tax official interviewed explained were more active in blocking reforms:

... some did have power or a high position which made it difficult for new people who wanted to change to reform because of them. Some, for example those who have already been working for thirty years and got used to the system and whose mindset has been like that, have been very difficult to persuade to change.

Business associations have been lobbying for business-friendlier tax administration and a fairer distribution of the tax burden. Invited to meetings with Parliament, the Ministry of Finance and the Directorate General of Taxes, they seized their opportunities to present their concerns, ideas and recommendations. "[I]t is widely held that KADIN (the Indonesian Chamber of Commerce and Industry) played a central role in persuading the DPR to pass the 2007 Tax Administration Law, and that it has been pushing for both the income and VAT bills to be passed in 2008" (Ashcroft/Cavanough 2008: 14).

<sup>87</sup> That is the: Secretary General, Director of Internal Compliance and Human Resources Transformation, Assessor in the Area of Tax Services, Director of Examination and Billing, Assessor in the Area of Human Resources Control and Guidance, Assessor in the Area of Supervision and Enforcement of Tax Laws, Heads of Jakarta Tax Offices, Directors of Special Tax Offices, Directors of Large Taxpayers Offices, and the Director of Sulawesi Tax Office.

<sup>88</sup> Mid-2010, the DGT estimated that about 5.000 to 6.000 of its 32.000 employees were not able to adapt to the 'modern' working situation (K 30.06.2010). As described in Section 4.3.2, DGT has to wait until these individuals retire, as civil service regulations make it almost impossible to discharge officials. The only measure they can take is to shift officials to less relevant offices.

Democratic Indonesia's media have been outspoken about corruption in government and administration. Anti-corruption and reform issues form an important part of the daily public discourse. The national press has a stake in agenda-setting, stakeholders thus each tried to win their support. Finance Minister Sri Mulyani Indrawati, a media darling affectionately called "Bu Ani" by many journalists, regularly met with journalists, in particular the chief editors, to explain what she would do, how and why. The DGT invited to press conferences, gave personal interviews and bought advertising space for public information campaigns. Business associations provided input to the media, while legislators, in particular those of Commission XI, similarly got in contact with the media when they felt that would be advantageous. Overall media outlets aimed to provide a balanced view of the issues, yet citizens could not fully rely on their objectivity, as some television stations, radio stations and newspapers are owned by influential politicians and/or businessmen and some journalists can be bribed. Further in recent years, chief editors have become increasingly cautious about publishing critical reports on powerful individuals or companies out of fear of being taken to the courts charged with defamation (Freedom House 2008, 2009a; cf. Tapsell 2012).

The analysis of domestic actor support for tax administration reforms indicates potential for change. For much of the reform period, leadership has been strong and stable. Comparatively long term technocratic appointments of the minister of finance and the director general of taxes have allowed for programme continuity, reliability and persistent pressure. Presidential backing has been solid and legislative support good enough. While vested interests tend to block major changes that threaten their assets, reforms are neither fully stopped nor severely undermined. Interference into human resource management decisions exists, yet the economic elite's grip on key-decision-making positions is not yet strong enough to dictate decisions. Tax officials for the most part have accepted the 'paradigm of change'; some have become real advocates of change. Many taxpayers similarly saw potential benefits in tax administration reforms. The media overall has been supportive in providing the grounds for corruption-issues to be publicly discussed and the public informed on reform processes.

#### **4.4.2 Donor Influence**

The 1997/8 Asian financial crisis's severe impact on the Indonesian economy forced President Soeharto to request assistance from the International Monetary Fund (IMF). The IMF agreed, yet made loan disbursement contingent to the implementation of a conditionality policy agenda. The Fund and other external donors pressured the government to overhaul the country's institutional and economic regulatory frameworks in line with the Post-Washington Consensus paradigm. Within the fiscal adjustment programme, the IMF requested the DGT to develop a short-term reform strategy to increase Indonesia's tax yield and improve its investment climate in late 2001 (Brondolo 2008: 20). Hence, in collaboration with external donors, the tax authority created and introduced first quick-win measures. As the DGT's Director of Business Processes Transformation recalled

the trigger [that prompted the start of the reforms] is basically by the Letter of Intent or commitment with the IMF. The IMF kind of proposed making this new office [Large Taxpayer Office], because they were concerned regarding our capability to generate revenue. ... So we started ... (Robert Pakpahan in IfSS 2009a; see GOI 2000; 2002).

Economist Faisal Basri also commented "Had it not been for the IMF, I believe, the government would not have made the reform program" (JP 07.06.2002). Back then, however, donors perceived a limited implementation capacity at the DGT. An international organisation representative interviewed noted, that "... at the time it seemed unlikely that Tax would have been willing or able to engage in any large-scale reform, but things have developed differently".

In the course of the IMF's engagement, relations between the Government of Indonesia and the Fund became increasingly strained. Resentment of foreign domination motivated government not to extend the IMF programme beyond the expiration of the Extended Fund Facility by end-2003. In consequence, Indonesia had to pay back the loans it had received during the bailout and lost the option to reschedule debt through the Paris Club. Pressure on the government's budget increased as much as putting at risk the state's economic viability. Indonesia's government rationally agreed to post-programme monitoring and continued annual Article IV consultations.

Following consultations with a wide-range of national and international stakeholders, the Indonesian government developed a post-IMF economic policy package, known as the White Paper (see World Bank 2003b: 7-10). Government and international donors concurred that the country had to restrain its expenditures and increase non-oil domestic revenues to maintain macroeconomic stability. Therefore, the "modernisation and reform of the national tax system" remained one of the measures emphasised.

In 2003, Finance Minister Boediono approached the IMF and the World Bank for technical and financial assistance to lock in reforms at his ministry and its directorates general. While Indonesia was not dependent on international partners, it regarded such partnership as a good opportunity to further the country's interests. Following extensive discussions and multilateral negotiations the parties agreed to pursue a three-phased government financial management and revenue administration project (GFMRAP). Initially, it was to run from 2004 until 2009, later it was extended to 2013 (World Bank 2004). The GFMRAP is not an explicit tax project, but an 'umbrella' for sequencing reform activities in the areas of public financial management, customs, tax, and the tax court. The tax component, whose share in the whole project was comparatively small, was supposed to stand in the focus of phase three. It was decided that the DGT during phase one and two would receive technical assistance only. Bilateral donors, including the development agencies of Canada (CIDA), Australia (AusAID) and the United States (USAID), would engage in DGT's modernisation and reform through financing grants, co-lending and technical assistance. A multi-donor trust fund to support public financial management and revenue administration reforms (PFM MDTF), administered by the World Bank and funded by contributions of the European Union, the Netherlands and Switzerland, was then established to support the medium-term reform agenda.

By 2009, at least seven donors were engaged with the DGT. The cooperation promised benefit for both Indonesia, which needed help as the required expertise to reform the tax administration was not to be found anywhere in the country (Indrawati 2011), and the international finance institutions and donor countries. The reform's prominence promised donors visibility and credibility. Further, a reliable tax administration was likely to lower business costs, encourage investments and help stabilizing Indonesia's macroeconomics. This in turn could benefit a range of distinct national economic and security interests. Engagement thus started early and intensified when donors perceived the coming of a "golden age" with reform-minded individuals taking the lead.

The IMF and the World Bank took major roles in providing analytical and advisory support to the DGT. Initially, their support focused on the development of a road map for tax administration reform, yet expanded quickly to other areas of tax administration. An international organization representative interviewed explained why and what conclusions were drawn: "This is a low capacity environment. In this environment we had between ten and fifteen resident advisors at any given time in Jakarta". In addition, a large number of short-term advisors working on specific business processes, such as planning, compliance, audit, collection and enforcement, were dispatched and regular revenue administration missions conducted (see International Tax Dialogue 2011).

Australia conducts a peace and security-focused aid policy. Due to its proximity to Indonesia, it has been particularly interested in supporting economic and social stability and building prosperity of its neighbour country. Australia provides more support to Indonesia than to any other Asian country (AusAID 2006: IX, XI). AusAID continuously assisted DGT's transformation efforts. The technical advisory management facility for economic governance (TAMF III), the tax sub-facility and its successor programme Australia-Indonesia Partnership for Economic Governance (AIPEG) engaged in a widely dispersed area of activities, including the development of strategic and operational plans for transformation, human resource management, tax compliance, and internal and external communications (AIPEG 2011a; 2011b). Further AusAID-funded specialised training projects to improve service standards and train trainers (Box Hill Institute 2011) and facilitated exchange between the Australian Taxation Office and the DGT (Winter et al. 2011: 20-24).

Japan pursues a strategic partnership policy with Indonesia. Japan's economic interests are substantial as Indonesia acts as a supplier of natural resources, is a major export market, important manufacturing base, and occupies a geopolitically important location vital to Japan's shipping lanes. Indonesia for decades has ranked among the major recipients of Japanese ODA (Strategic Asia Indonesia 2008). A focus of JICA's programme has been the promotion of "sustainable growth driven by the private sector"; financial sector reforms are a priority area. Confidence-building has long been a priority of Japan's development cooperation with Indonesia. A large number of Indonesian civil servants have been trained in Japan, many via the Professional Human Resource Development Project (PHRDP), which has been in existence since the 1980s

(Artjan 2011: 381-385).<sup>89</sup> JICA and the Japanese National Tax Agency similarly have been involved in training and education measures. In cooperation with the National Tax College, DGT officials were invited to participate in international seminars on taxation ranging from few weeks to several months. Others, foremost mid-career staff, funded mainly by World Bank and ADB scholarships, were given the opportunity to pursue graduate studies in public policy, taxation, planning and management at Japanese universities (National Tax College Japan 2009).

The United States' interest in Indonesia centres on counterterrorism and security objectives. As counterterrorism includes prevention, the United States engagement extended also to areas beyond military and security assistance, in particular good governance reforms (Lum 2008). The US Treasury provided technical assistance towards the establishment of a data processing centre in Jakarta, and branch centres in Jambi, Surabaya and Makassar, taxpayer service policies and procedures, and public relations.

Sweden, whose ODA "served as a projection of Swedish domestic values and as a vehicle for its global designs" (Hook 1995: 93), held a minor role. SIDA and the Swedish Tax Agency focused on DGT's audit function, provided advisors and organised study tours (DGT 2007b: 55f; World Bank 2008b: 24f, 34-38).

The number of implementing agencies contracted by the different donor agencies is unknown. They include international agencies and their local branches, such as AC Nielsen, A.T. Kearney, Deloitte, Hay Consulting, KPMG, and Watson Wyatt.

Both donors and the DGT claim that they successfully contained risks of donor fragmentation through informal donor coordination facilitated by the IMF. International organisation representatives interviewed explained:

Among the donor community the approach is very well coordinated ... The Fund [IMF] helps the new donors to interpret what is needed and what is not. ... [The IMF] has developed donor coordination into a more client driven affair with annual meetings chaired by Robert Pakpahan, and they are all aligning it to the strategy and all that. There is little conflict in that area, which is surprising given the number of people that come and I ascribe that largely to the Fund.

The donor community is pulling in the same direction, we are not putting conflicting ideas into the head of the DGT; they are not getting confused.

International donors have played a catalytic role in facilitating and supporting progress. While they had the power to impose conditions on their grants and loans and to insist on certain policies or withdraw, the perception is that much decision-making power was left with the local counterparts, the Ministry of Finance and the DGT.

The donor community has given them a wealth of ideas, not all ideas they have accepted. They have rejected more than they have accepted, but what they have accepted is enough to put very good sound business rules into place. ... They know very clearly where they are and where they want to go (Interview: International Organisation Representative).

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<sup>89</sup> Other destinations, particularly until the mid-1990s, included the US, UK, and Canada. Since, the majority of civil servants were sent to Japan. For a case study on the Ministry of Finance/HIID training programme, which between the early 1980s until the mid-1990s allowed more than 300 finance officials to pursue higher degrees in the United States, see Lippincott, III (1997).



A wide range of donors engaged in a wide range of activities has the drawback of breadth versus depth. During the initial stage of reforms this posed little problems, as it allowed for the introduction of a number of “quick wins”. These early results generated reform momentum at the DGT and raised public awareness, yet evidence suggests that these were insufficient for real change. Hence, donors pressured senior management to push for deeper and more focused reforms if substantial assistance shall be continued. Around that time, the Indonesian government announced a paradigm shift in donor relations that was to be defined by the “Jakarta Commitment”. The official intention is to raise aid-efficiency, yet critics argue that the Indonesian government aims to dictate the strategic, financial and administrative terms of relationship.

The Indonesian government and the international community agreed that major efforts at improving the DGT's information and communications technology are necessary before other issues can be addressed effectively. Therefore, tax administration reforms were taken out of the GFMRAP and World Bank staff drafted a new large-scale stand alone project for Indonesian tax administration reform (PINTAR) to run from 2009 to 2015 (World Bank 2008b). PINTAR is designed to focus on the automation of Indonesian tax administration and aims to develop an integrated system by 2014. It is composed of four major components: increasing the efficiency of taxpayer data collection and management, human resource management, strengthening the compliance management system, and project and change management. The launch of PINTAR has been delayed as the DGT experienced problems in fulfilling prerequisites for the World Bank to issue its ‘no objections letter’. In 2012, international donors were pessimistic about future prospects as very little had moved during the past two years.

The analysis of donor cooperation pointed out, that while Indonesia started its tax administration reforms mainly by external pressure it later took over the ownership of the reforms. Indonesia found itself in a comfortable situation with a lot of donor support at hand. Donors proposed a variety of assistance activities the MoF and the DGT could choose from. Donor fragmentation has not been observed. In this regard, the conditions for reform have been favorable. The following chapters investigate how the DGT has made use of its opportunities and dealt with the stumbling stones.

#### **4.4.3 Change Management**

##### *Internal Change Management: Carrots and Sticks*

In 2000, the DGT declared its new mission: “To become a public service model which operates a system and management of taxation at world-class standards, is trustworthy and a pride to the public”. It presented a general reform strategy and adopted new organisational values, including professionalism, integrity, discipline, transparency, accountability, meritocracy, and self-reliance.

Beyond rhetoric, however, initially few serious implementation efforts could be observed. Reforms were discussed and organised by an ad-hoc team only. Mindset change was hardly addressed and few efforts to distribute the reform message among tax officials and the public nationwide were made. Within DGT, so-called morale,

ethics and integrity reforms obliged tax officials to take part in collective daily prayer and worship. Moreover, some officials were invited to participate in organised management trainings for the heart and the soul [*qalbu*] and to go on pilgrimage. Besides, a code of ethics and public relation strategies, as suggested by the IMF, were developed.

DGT's code of ethics stipulated twenty general rules of what tax officials should do and twelve general rules of what they are forbidden to do in performing their duties and tasks. Initially, however, the code applied only to a tiny fraction of DGT employees; those working at modernized offices. Also, the code was vague, as neither explicit performance targets nor sanctions, going beyond the standard sanctions for civil servants, valid since the 1980s, for failure to comply were defined.<sup>90</sup>

DGT senior staff seemed to have preferred maintaining the status quo. As mentioned earlier, international donors perceived a lack of willingness at DGT to reform at that time. A tax officer, who has been with the DGT since 1997 and pursued PhD studies in Japan, later strengthened the perception's validity:

... the DGT leaders at that time were like having two agendas in their hand. They supported the pilot project of modern tax office because it was a top-down decision from IMF and government. Meanwhile, they also maintained the old practice and corrupted rule of the game. The only difference was that the practise was not openly discussed, but everyone inside the organization knew that. Therefore, the tax office modernisation was also called 'silent revolution', because the top leader never clearly stated the reform programs in public sphere and there was a high possibility that the reform might not succeed and overcome the high pressure of well-established corrupt behaviour between tax officials and taxpayers (Artjan 2011: 400).

Moreover, economic ministers hardly pressed for reforms. The lack of strong initiative became particularly apparent following the 'party-negotiated' installation of Aburizal Bakrie as Coordinating Minister for the Economy and of Jusuf Anwar as Finance Minister, and the extension of Hadi Poernomo's term as Director General of Taxes right after Yudhoyono's re-election in 2004. Economist Kwik Kian Gie described Bakrie as "... completely clueless about what should be done" (JP 03.09.2005) and Anwar attracted public attention when in response to Transparency International's report that tax and customs were among Indonesia's most corrupt institutions he stated

I don't care. All I care about are the improvements in governance and oversight that are taking place. ... The claim that 40% of the country's tax revenues are embezzled is 'bullshit'. ... We have done a lot in trying to create accountable and transparent systems in the tax and customs services (JP 18.02.2005).

The opposite, namely "Reform in tax regime not going anywhere" as pointedly formulated by an Indonesian journalist (JP 27.12.2005), in the headline to his article on

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<sup>90</sup> There are three categories of sanctions: light [*ringan*], medium [*sedang*], and heavy [*berat*]. Sanctions include: oral warnings; written warnings; written statements of dissatisfaction; decrease in salaries, usually only the supplementary part, for a maximum of one year; suspension of promotion; degradation; and ultimately honorary or ignominious dismissal. Rules were neither elaborated nor clarified, which left civil servants with wide discretionary power what to sanction and how to sanction.

the deliberation of the tax law amendments, reflected the common impression of tax reform observers at that time.

Amidst mounting criticism of economic observers, media and the business community, Yudhoyono, who had entered his second-term, decided to replace the economics team in December 2005 (JP 10.10.2005). When Boediono was appointed Coordinating Minister and Sri Mulyani Indrawati Finance Minister, reform became more vigorous, organized, and directed. The Finance Minister took drastic personnel consequences in particular at senior management level: She dismissed the Director-General of Taxes, amended who participated in the reform team and actively took part in the new Director General's decision-making who was promoted DGT echelon II staff and where these officials were placed. Darmin Nasution, the new director-general, alike effected a major staff replacement within the tax office. Still, reform teams remained ad-hoc teams; its members held regular positions within the Ministry of Finance or the Directorate General of Taxes, and fulfilled reform tasks as a side-job. This approach had two downsides, for the officials involved it meant a double-burden, for modernisation and reform it implied reduced attention. It took about two years to ameliorate these problems by building a full-time business process transformation unit, embedded into the official organizational structure of the DGT.

Sri Mulyani personally was very involved in pushing for a modern, well-reputed tax administration. She had a clear idea what she wanted to do; she initiated regular structured meetings with the DGT's senior staff to discuss reform and stimulate ownership. Also, she demonstrated physical presence by regularly using an office at DGT headquarters next to her office at the Ministry. At many occasions, Sri Mulyani reminded high-ranking staff to take responsibility and act as role-models. They should

... be ready to do and to give an example. They themselves are not going to bring their crony or friends, they themselves respecting the bureaucracy and the meritocracy, and are ready to make the difficult decision of punishing their own friends (Indrawati in IfSS 2009b).

Sri Mulyani created reform space. Besides building intrinsic motivation by appealing to tax officials' personal pride, she relied on extrinsic motivation by adopting a carrot and stick approach. As many of the measures she wanted to introduce were outside the general framework of national civil service regulations, the Finance Minister proactively requested exemption from MenPAN. Permission was granted; the Ministry of Finance was declared a pilot project for administrative reforms.<sup>91</sup>

In the eyes of DGT staff, the revision of the remuneration scheme for tax officials, which entailed a phased significant pay rise rewarding tax officials who committed to modernise, has been one of the biggest motivators, for Sri Mulyani it has been a *conditio sine qua non*.

Since 2007, tax officials' remuneration [*THP*] has consisted of four components: (1) salary [*gaji*], which is based on the employee's basic salary depending on his/her grade, rank and period of employment in that particular grade, plus a multitude of allowances

<sup>91</sup> The other pilot projects later chosen were the Supreme Court and the Supreme Audit Board.

and entitlements, (2) special allowance awarded to Ministry of Finance officials only [*TKPKN, tunjangan khusus pembinaan keuangan negara*] which is based on job difficulty analysis and the employee's according position on a 27-point grading scale, (3) allowance for special activities awarded to DGT officials only [*TKT, tunjangan kegiatan tambahan*] which is based on the responsibility and complexity of the tax official's job description, and (4) an annual performance reward specifically for DGT officials [*IPK, imbalan prestasi kerja*], equivalent to twice the TKPKN.

As a result, the legally provided monthly remuneration of tax officials became three to five times higher than the remuneration of other civil servants. A junior supervisor [*pengatur muda*] who just entered the DGT receives a monthly THP of at least Rp 6.4 million already, a first class junior superintendent [*penata muda tingkat I, III/b*], the category most tax officials belong to, receives at least Rp 11.9 million, while the director-general [*pembina utama, IV/e*] is paid at least Rp 70.7 million.<sup>92</sup>

Tax officials' remuneration therewith is commensurate with, for low-ranking officials even higher than, the remuneration they would receive in the private sector. Differentials at highest management levels are in keeping with public-private sector differentials in other countries worldwide. The excuse of low salaries as justification for misconduct became even more invalid than it had already been.

Further, Sri Mulyani promised that she would not only recognise, but reward those who are disciplined, honest, and diligent, among others with letters of appreciation, reward certificates, promotions, and scholarships for training and higher degree courses abroad. Within the same realm, the Finance Minister expressed clearly that she intended to make an end to tax officials' "zero cost with total benefit" calculation by personally threatening her staff, that she would strengthen/install control mechanisms, sanction misconduct, and give harshest punishments for corrupt behaviour:

I am not going to let you work here and I will put you in prison; that's going to be my policy. ... If you want to be rich, out, you can do business outside (Indrawati in IfSS 2009b).

To set an example, in late 2007, Sri Mulyani moved out all 70 tax officials at the Human Resources Department after reports of rent-seeking in the rotation of officials had leaked. Further, she initiated "a 'social sanction', in which officials caught receiving bribes had to apologise and read out loud a statement of regret before all Finance Ministry officials" (JP 28.04.2009a).

Slowly, but steadily, the number and scope of control mechanisms was raised. To improve discipline, fingerprint identification machines to record tax officials' presence at the office three-times daily were installed between 2005 and 2007. Being late or

<sup>92</sup> The author's calculations are based on PP No. 8/2009, Perpres No. 26/2007, Kepmenkeu No. 290/KMK.01/2007, Kepmenkeu No. 164/KMK.03/2007, SE No. SE-05/PJ.1/2006, and its attachments. For example, the remuneration of the director-general, i.e. echelon Ia, golongan IV/e, job grade 25, has been calculated from the following amounts: basic salary Rp 2.363.100, structural allowance Rp 5.500.000, TKPKN Rp 36.770.000, TKT Rp 20.000.000 and IPK Rp 6.128.333. The THP are likely to be underestimates as allowances that are paid as salary are totally intransparent and can add up to millions of Rupiah. Further, at present Indonesia's civil servants receive a 13<sup>th</sup> month salary.

absent meant allowances were cut by certain percentages, while being present meant receiving additional allowances (K 05.08.2010). By 2007, the Code of Conduct, shortened to nine obligations and nine prohibitions, was extended to be applied to all tax officials nationwide. Handbooks describing how the Code should be applied in a range of situations tax officials commonly experience were published and distributed (Permenkeu No. 1/PM.3/2007; DGT 2008a, 2008b).

By 2008, a DGT Directorate of Internal Compliance and Transformation of Apparatus Resources [*KITSDA, Direktorat Kepatuhan Internal dan Transformasi Sumber Daya Aparatur*] under the direction of an echelon II official was created.<sup>93</sup> All KITSDA employees had to sign integrity pacts which committed staff to keep secret the identity of informants. The intention was to reduce the perceived burden of making complaints. KITSDA investigates complaints, yet does not act proactively. Table 4.3 reports the development of disciplinary sanctions issued nationwide between 2001 and 2011.

TABLE 4.3: *Disciplinary Sanctions towards DGT Staff (2001- 2011)*

Sanctions	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
Light	276	239	435	149	180	102	141	253	424	n.a.	n.a.
Intermediate	17	10	17	13	5	37	37	61	28	n.a.	n.a.
Heavy	34	41	34	43	66	71	76	92	64	64	32
Total	327	290	486	205	251	210	254	406	516	657	263

<sup>a</sup> Reasons for why a tax official was sanctioned and reliable figures on the number of staff who were dismissed are not available. Heavy sanctions do not necessarily have to be related to a misuse of tax official's authority. Moral offences, e.g. a tax official having a concubine or getting divorced without having obtained prior written approval, similarly can lead to sanctions up to dismissal.

Source: Directorate General of Taxes (2010a; 2012).

In 2010, an independent five-person Taxation Supervisory Committee [*KPP, Komite Pengawas Pajak*], directly reporting to the Minister to oversee both Tax and Customs was established.<sup>94</sup> KITSDA and KPP set-up complaint centres to receive complaints and hints via e-mail and hotline on any form of deviations both from the public and from within the DGT. Further, the DGT signed memoranda of understanding with the Corruption Eradication Commission [*KPK, Komisi Pemberantasan Korupsi*] to fight corruption, and with the Financial Transaction Reports and Analysis Centre [*PPATK, Pusat Pelaporan dan Analisis Transaksi Keuangan*] to mitigate and eradicate money laundering and other tax crimes. By 2010, DGT obliged more than 4.500 tax officials to

<sup>93</sup> Moreover, at the Ministry of Finance's Inspectorate General a new investigation unit (*IrBid Investigasi*) was created, to plan, coordinate and back up functions of investigation units at the ministry's directorate generals. Members of this unit were selected based on audit skills, motivation and integrity, which anecdotal evidence suggests to have been assessed by the use of lie detectors during interviews.

<sup>94</sup> The individuals appointed were Anwar Suprijadi, former director general of customs, Abdul Anshari Ritonga, former director general of taxes, Hekinus Manao, the inspector general of the finance ministry, and two professors from the University of Indonesia, Sidharta Utama and Hikmahanto Juwana, both experts in tax issues. Very little information on the KPP and their work exists, which makes an assessment of its effectiveness and impact on the tax administration's practises extremely difficult.

submit personal wealth reports [*LHKPN*] to KPK, additionally PPATK was requested to investigate money flows and transactions involving the bank accounts of 15.000 tax officials (JG 06.04.2010; JP 06.04.2010a).<sup>95</sup> Tax officials were to get the perception that, under their new leadership, they had to be honest when they wanted to progress in their careers and that dishonesty would put them at risk of losing their job.

While reforms centred in Jakarta, efforts were made to spread the reform message to tax officials in all regions of the archipelago. A finance official interviewed maintained “the Ministry of Finance and DGT make sure that the information composed by the leaders does reach and is understood by all staff members”. Apart from written information and instructions distributed via postal service, e-mail and intranet, DGT relied on personal top down as well as peer-to-peer communication. Transformation directors visited regional offices to give talks and convince staff to participate. Tax officials from the regions on the other hand were invited to take part in modernisation trainings in Jakarta, where they would learn how to pass on knowledge back home, e.g. in workplace learning groups. The DGT also experimented with new media such as SMS, Facebook, and Twitter to stimulate tax officials' participation.

Leaders tried to explain rationally why tax officials should change and what benefits they would gain. Moreover, they explained what failure would mean for their personal and the office's credibility. An interviewee described an episode of how the Director of Business Process Transformation tried to convince audit staff, who turned out to be particularly resistant to reforms, why tax corruption was not acceptable, he experienced:

One billion dollars will build 50 hospitals, 250 high schools, Pak Robert explained at a public meeting. All 18 directors listened to this and none of them politically could sit down against this.

At least in public, the audit staff had to consent as not to lose face. The more moderate auditors, being more in favour of reform, then continued to influence their colleagues.

Yet, it turned out that “[s]ocialisation of rules and regulations to all tax offices in all regions is not easy. ... Even within the range of us internally, we experience obstacles and constraints” a member of the transformation team explained (FGD: Tax Officials). DGT lacks human resources, both in number and ability, to effectively train its entire staff body regularly. Overall, the perception is that the message reached most tax officials in the capital region and there has been widespread support of reforms:

If we cannot handle, go, transfer to another institution or retire. Our habits and routines have to change (Interview: Tax Official Management Level).

We are just fine. The remuneration is sufficient, there is something in return. ... From the inside we evolve into something better (Interview: Tax Official Middle-Level).

The movement now is a movement within the organisation. Unlike most transformation projects it has buy-in from the stakeholders, they may not like it all, like the audit staff (Interview: International Organisation Representative).

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<sup>95</sup> In 2012, the KPK announced that it would also require civil servants to explain the origin of their assets (JG 10.12.2012). If implemented and meaningful sanctions for failure to report were enforced, this would put significant pressure on the state's employees.

The further away from the capital and the lower the taxing potential of the region, the more tax officials' understanding and support had to be doubted however. In this regard, DGT's rotation policy could have not only the potential downside of disruption and discontinuity to reform activities rendering accumulated expertise and specialisation unutilised, but may have at least the benefit of taking the general ideas of reform along with reform-minded staff to the regions.

*External Change Management: From shock therapy to image campaign*

Feeling the pressing need to raise tax revenues, the DGT declared 2003 the "Year of Law Enforcement" and decided to adopt a get-tough approach towards alleged tax dodgers. The previous year, letters had informed 150 taxpayers that they had 14 days after public notice to settle their tax arrears, and had threatened them that if they failed to do so they would have to face severe sanctions.<sup>96</sup> In 2003, these sanctions were to be enforced. Following 'unintended' public shaming by leakage of identities, alleged tax debtors faced enforcement actions, including foreclosure and seizure of assets, travel bans, and detention [*gijzeling*].

The wide power and discretion DGT enjoyed allowed the tax authority to imprison alleged tax evaders with arrears above Rp 100 million, without charge or prior trial for a maximum period of one year before the case had to be handed over to the police.<sup>97</sup> Until 2004, the issuance of five detention letters became public. Two Indonesian, one British, Canadian, and US American citizen, representing the companies PT EI, PT Indo-Pacific and PT Karaha Bodas, were alleged of non-payment of corporate taxes and accounting fraud. Three of the five businessmen were imprisoned in special facilities at Rutan Salemba and Cipinang penitentiary institution, top-security prisons in Jakarta, yet one supposedly fled and the others were released upon payment of 10% of the disputed amount. Afterwards, not one was legally charged (JP 19.11.2003; MT 29.11.2004).

According to the DGT, another 68 alleged tax evaders, including 18 foreign nationals, were blacklisted for imprisonment. No information could be obtained what happened to these cases. Yet, there are indications that most defendants settled their disputes by negotiations with tax officials. Business organisations heavily criticised the detention policy as being prone to abuse, creating another gateway for collusion and extortion. Similarly, DGT's slogan "Wise people pay taxes" [*Orang bijak bayar pajak*], by some people was interpreted rather as a threat than a benevolent advice. DGT reported that tax revenues climbed following the introduction of detention (AT 19.11.2003).

By contrast, the Indonesian government regularly reported the names of "the most compliant" corporate and private taxpayers [*wajib pajak patuh*] and rewarded them with preferential treatment. These included accelerated tax refund, simplification of the

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<sup>96</sup> To create deterrent effects, DGT headquarters had instructed regional offices on Java to investigate at least two taxpayers, and regional tax offices outside of Java to investigate at least one taxpayer (DGT AR 2003: 18).

<sup>97</sup> The detention letter was issued by a tax official upon the consent of the minister of finance for national taxes or the governor for regional taxes.

excise tax paying procedure and speed-up of import and export clearances. The criteria to be included into the list were questionable however, as individuals whose income tax was automatically deducted and did not need any special compliance could be awarded the special status also. In 2004, DGT conducted a glamorous ceremony entitled "My Offerings Concert" [*Konser Persembahanku*] to honor the country's 262 most compliant taxpayers. The concert, staging much adored Malaysian and Indonesian singers, at the Jakarta Convention Center allegedly cost around Rp 1 billion. Peculiarly, many of those honored were cabinet ministers, government officials, businessmen and businesses that were close to President Megawati. Individual recipients included her husband Taufik Kiemas, her brother Guruh Soekarnoputra, prominent Muslim cleric Abdullah 'Aa Gym' Gymnastir, Vice-President Hamzah Haz, House of Representatives Speaker Akbar Tandjung, the People's Consultative Assembly Speaker Amien Rais, Supreme Court Chief Bagir Manan, Attorney General M.A. Rachman, Finance Minister Boediono, and Director General of Taxes Hadi Poernomo (JP 26.02.2004). Several of these individuals, like Kiemas, Tandjung and Poernomo, had the reputation of being involved in money politics, deal-making, and corruption. One might wonder whether tax harassment on the one hand and preferential treatment on the other was practised with a special, hidden purpose.

Following President Yudhoyono's election, the DGT changed its taxpayer education strategy. From enforcement the focus slowly shifted towards motivating voluntary compliance, by informing citizens what taxes are, why they are needed and how taxes are processed. Further, the tax authority worked at the restoration of the DGT's image. Late 2004, DGT conducted a contest to elect the tax administration's new mascots "Arjuna & Srikandi Pajak" in eight cities nationwide.<sup>98</sup> Two bachelor's degree students were chosen as tax ambassadors, addressing in particular the younger generation, putting forward the message of being aware and concerned of taxes. The ambassadors were involved in public events organised by the DGT and became the heroes in a series of low-budget public service advertisement spots aired on national television. In these spots, playing primary school children experienced a certain problem, Arjuna and Srikandi came to help and explained that the problem, e.g. a broken road, insufficient policemen, costly hospitals and schools, can be solved through taxes. Taxing would mean to take the money from those who have a little spare and give it to those who have too little. Paying taxes was similar to sharing and it benefited everyone (DGT 2005). DGT's new slogan "Settle your taxes, control their use" [*Lunasi pajaknya, awasi penggunaanya*] reflected this idea.

Since 2007, DGT's tax advertising campaign has started to expand, become more professional, and, while no one interviewed was prepared to give away any figures related to the budget of the Directorate of Tax Counseling, Service and Public

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<sup>98</sup> Arjuna and Srikandi, heroic figures originating from the Hindu Mahabharata epic, became popular by Javanese *wayang* (shadow puppet theatre). Arjuna, a brave warrior, taught his junior wife Srikandi how to use the bow and arrow enabling her to attack even the strongest enemy. To Indonesians, Arjuna represents male beauty, integrity and loyalty, while Srikandi stands for an intelligent, warm-hearted, courageous and assertive woman. Both recurrently are mentioned in Indonesian political and social life.



Relations, certainly also far more expensive. The goals remained the same, raising tax revenues and restoring the image of the tax authority. The DGT suddenly was almost everywhere: on the streets, in busses and trains, in malls, at public events, at schools and universities, with business groups and associations, accounting firms and at hospitals, at parliaments, with government departments and institutions, at golf clubs and community groups, in newspapers, magazines and journals, on the radio, television and internet, as well as at the phone (DGT 2007a; 2009a).

Arjuna and Srikandi were replaced by Kojib, a friendly honey bee mascot, which physically turned up at many occasions and was printed on advertisements, tax information material as well as official documents, e.g. tax return receipt forms. Tax officials pointed out that the bee was chosen as it symbolises diligence and social behavior. Bees would collect pollen, not causing discomfort to anybody and sting unless they were attacked, turn the nectar and pollen into honey, and benefit the flowers where the pollen was taken from, their population as well as their environment. Indonesian citizens should act like flowers, voluntarily sharing their excess, while tax officials were supposed to be like honey bees, busily collecting and happily working for the benefit of everyone. Indonesia should develop into a gorgeous sea of blossoming flowers.

This message was carried forward in DGT's advertising strategy. A large number of public relations materials were produced. The campaign predominantly targeted Indonesia's middle class and the young generation. TV spots, between one and five minutes in length, told a broad variety of stories showing tax collection in a positive light. In 2007/8, humorous spots with the tagline "These days you still don't pay taxes? – What's the world going to say!" [*Hari gini gak bayar pajak? Apa kata dunia!*], narrating why citizens should have a tax identification number, how easy and uncomplicated paying taxes was, and why paying taxes was important were developed (DGT 2007d). The next generation of spots, responding to public sentiments following major tax scandals that hit the country in 2010 (discussed in more detail in Chapter 4.5.2), focused more on appealing to Indonesians' patriotism and morale, and depicting the tax authority as a service provider.<sup>99</sup> Heart-touching stories, constructing a linear relationship between tax revenues and socio-economic development, as well as energetic stories featuring the chairmen of Indonesian business associations and the vision of Indonesia as a prosperous and affluent country were told. The featured slogans "Taxes unite hearts and build the country" [*Pajak menyatukan hati, membangun negeri*] and "Proud to pay taxes" [*Bangga bayar pajak*] spoke to taxpayers' intrinsic motivation. Taxes were no longer portrayed as a duty, but as a necessity, a civic virtue and a privilege. Indonesia's tax officials were portrayed as attentive, polite, accurate, fast and honest (see DGT 2011).

Tax education obtained a more central role. Tax officials participated in radio and TV talk shows, tax information was distributed via SMS, E-mail, Twitter, Facebook and

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<sup>99</sup> One of the most fundamental ideological principles in organising the Indonesian state is *gotong royong*. Meaning mutual assistance or mutual help, *gotong royong* instructs group members to help any group member that finds himself in distress.

YouTube, and the DGT conducted spot visits and tax road shows at public places. Further, in 2008, the tax authority inaugurated a contact center, *Kring Pajak 500200*, where taxpayers could ask for information, and direct complaints and comments, and began building internet-based information.<sup>100</sup> Starting tax education early has been a central concern. In 2008, the DGT partnered up with KidZania Jakarta, opening up a tax office establishment to introduce children to the world of taxes by learning about taxes, obtaining a NPWP and filing a tax return.<sup>101</sup> According to KidZania's management, within three years about 63.000 kids had visited the tax establishment (TN 01.11.2010).

The DGT further reached out to schools and universities nationwide, lobbying for the insertion of tax education in school curricula, and local tax offices inviting students to tax edutainment events, including 'Pajak goes to school', 'Tax goes to campus', 'High school tax competition' and 'Fun trip to Pajak', under the common theme "Closer to Taxes" [*Lebih dekat dengan pajak*]. Tax representatives conducted a variety of activities with the students going beyond simple lectures: they invited students to interact, participate in performance and knowledge contests, and gave them promotional kits including souvenirs like T-Shirts, pens, key chains or stickers, food and drinks, as well as tax information material including leaflets and a NPWP-application form. The main message put forward was that taxes were nothing one had to fear, but a civic virtue which helps building Indonesia and one could be proud of.

As singing plays an important role in Indonesian popular culture to win hearts and minds, and woo the masses, the DGT composed a tax jingle, which states that "Paying taxes proofs one cares about each other" to be performed by bands, choirs, as well as to be sung together by all participants at DGT events nationwide (see DGT 2010c).

Overall, public response to the campaign was positive, yet there have been instances when the DGT's public relations backfired. Indonesians reinterpreted information they received and assembled it into a new framework which put the DGT in a bad light.

Deterrence policies meanwhile proceeded in the background. While no taxpayers were reported to have been arrested anymore, DGT claimed that it issued auctions [*lelang*], 56 times in 2006, 85 in 2007, blocked accounts 201 times in 2006, 831 in 2007, and issued 221 travel bans in 2006, 87 in 2007 (DGT AR 2007: 51).

The analysis of internal and external change management in regard of tax administration reforms shows that strategies applied have been distinct. Internally, a carrot and sticks method was adopted. Externally, the approach shifted from shock therapy to a public education and image campaign. Since the mid-2000s, change management has received much attention and significant resources. Tax officials'

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<sup>100</sup> According to DGT statistics, the public use these facilities foremost to make inquiries. In its first year, the call centre received about 230.000 incoming calls, of which about 30% were answered. Few complaints and suggestions were made, very few required follow-up (DGT 2010b).

<sup>101</sup> KidZania is a popular indoor theme park for children aged 2-16 located at an upmarket mall in Jakarta's central business district. It is a kid-sized replica of a city, with streets, parks, enterprises and offices. Children are able to role-play taking up adult jobs choosing between 100 different professions and occupations. Many establishments however are brand sponsored, providing corporate sponsors with a novel platform for advertisement to reach already the youngest.

remuneration was raised, so were the risks of misusing official powers. The DGT went high profile to inform citizens about their presence and educate them about taxes and ongoing reforms. Well-structured and intense these change management strategies had a significant positive impact on the course of the reforms. Awareness of taxation's importance was increased both among tax officials and (potential) taxpayers.

#### 4.4.4 Reform Dimensions

Since 2002, the DGT implemented a number of activities under its reform and modernisation agenda. These can be classified into three dimensions: organisational restructuring, human resources management and business processes improvement. The following sections outline key developments, not directly related to change management issues, in the reform of Indonesia's tax administration.<sup>102</sup>

##### *Organisational Restructuring*

Reforms were initiated with the organisational restructuring of the DGT. The idea was that these measures would have an immediate impact and that these visible results could then trigger both support and further activities as they proved modernisation was effective. The DGT's approach taken has been to pilot initiatives and review them before rolling them out nationwide.

In July 2002, following up on its "Knowing Your Taxpayers" campaign, the DGT started with the introduction of a Large Taxpayer Regional Tax Office, Large Taxpayer Office One and Large Taxpayer Office Two [*LTO or KPP Wajib Pajak Besar*]. The LTRO and LTOs initially focused on Indonesia's largest 200 corporate taxpayers and their 300 branches; in 2004 it was expanded by 100 additional large corporations.<sup>103</sup>

LTO vacancies, promising higher salaries, were advertised internally; all tax officials who perceived themselves qualified and were willing to reform could apply. By 2004, 253 tax officials had been recruited to the LTOs (DGT AR 2004: 8). The selected individuals were overall perceived as being of higher quality than the average tax official. To keep this advantage, special trainings for new LTO staff and regular special education courses for all LTO staff were offered regularly. Everyone had to commit to "providing the best service at the highest standard" (DGT 2012b).

Large taxpayer offices became the laboratory for introducing a wide range of "best-practise" changes to improve service quality and tighten the control on taxpayers and tax officials alike. First and foremost, the tax office's sections were reorganised based on functions that is the type of work performed. Each LTO would consist of a section of general affairs; data management and administration; taxpayer services; taxpayer's supervision and consultation; tax audit; tax collection; and tax auditors as an individual functional group. By creation of a modern, welcoming atmosphere, DGT's

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<sup>102</sup> For more detailed factual descriptions, see Brondolo et al. (2008: 20-36, 50-55), Pandiangan (2008: 6-62, 90-105), and Ministry of Finance (2008b). For references to related rules and regulations, see Ministry of Finance (2011a).

<sup>103</sup> For comprehensive lists of companies initially registered at LTOs I and II, see DGT (2003: 40f).

professionalism and commitment of becoming a customer-oriented agency was to be demonstrated. Tax offices' physical outline was thus overhauled, by dividing between front office and back office administration, upgrading furnishings, amenities and decor, as well as modernising technical equipment. New software able to manage cases was introduced, the SIDJP. Since, each LTO has been operating integrated service points [*TPT, tempat pelayanan terpaduh*], as taxpayers' "one-stop-service" point accepting tax returns and other documents to be processed by the tax authority, and provides help desks, including a touch-screen accessible knowledge-base, brochures and leaflets with tax-related information, to assist taxpayers. Moreover, account representatives, who are assigned to specific taxpayers and supposed to have specific knowledge about the taxpayer's business activities, e-tax return applications [*e-SPT*] for income tax, VAT and luxury sales tax returns, and e-payment facilities were introduced. Taxpayers were given the opportunity to submit complaints to a complaint centre. This opportunity was hardly used.

In 2009, a High Wealth Individuals Tax Office [*KPP HWI*] for the largest 1.200 individual taxpayers living in DKI Jakarta was added to the LTRO. According to the DGT, selection was assets rather than income based. Information was collected from open sources, such as the Forbes rich list.<sup>104</sup> By April 2012, the allocation of taxpayers to LTOs was reorganised. Since, the following LTO business type classification has been in force: LTO-1: mining, mining support services, financial services; LTO-2: industry, trading, services; LTO-3: industry, services, SOE, including their subsidiaries with direct or indirect ownership more than 50%, LTO-4: SOE services, particular individual taxpayers. LTRO then employed 566 tax officials and administered 2.284 taxpayers in total (DGT 2012b).

Following an overall positive review of LTOs, the transformation of Indonesia's tax administration from a type-of-tax-based organisation towards a function-based organisation, with regional and local offices organised by taxpayer segments, was gradually taken forward nationwide. In 2003, a Special Tax Office for State-Owned Enterprises [*KPP BUMN*], to be subsequently administered by the LTRO, and a Jakarta Special Regional Office [*Kanwil DJP Jakarta Khusus*] were established. The latter encompasses Foreign Investment Tax Offices I-VI [*KPP PMA*], a Listed Company Tax Office [*KPP PMB*] and Foreign Enterprise and Individual Tax Offices I-II [*KPP Badora*].

Medium Taxpayer Offices [*MTO or KPP Madya*], to cater for a region's 200 to 500 largest corporate taxpayers, and Small Taxpayer Offices [*STO or KPP Pratama*] merging KPP, KPPBB and Karikpa, for the remaining corporate, individual, as well as property taxpayers were first piloted in Jakarta. Other than LTOs and MTOs, STOs have a taxpayer extensification section and cater for a not predefined number of

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<sup>104</sup> In 2011, Credit Suisse estimated that Indonesia was home to about 112.000 US\$ millionaires and at least 12 US\$ billionaires (JP 21.10.2011).

taxpayers (DGT 2009e).<sup>105</sup> Account representatives at STOs are assigned to a specific local area rather than a specific taxpayer. In Indonesia's far-flung regions, small taxpayer offices were allowed to open branches in remote areas, the Taxation and Consultation Offices [*KP2KP*], to reduce taxpayers' compliance costs.

Headquarters, which previously was organised partly on tax administration function and partly on tax types (see Figure 4.6), was aligned to the new needs of a function-based organisation in January 2007. To become the "centre of policy making and analysis" (DGT 2007c: 18), tax-type-based directorates were removed, directorates were split, and three new directorates added. Since, headquarters has been organised with a secretariat directorate general and directorates for tax regulation I; tax regulation II; tax audit and collection; tax intelligence and investigation; tax extensification and appraisal; tax objection and appeal; tax potential, compliance, and revenue; tax counselling, service and public relations; tax information technology; internal compliance and resources transformation; and business process transformation (DGT 2009d). Further since 2007, data processing centres were to be set up in Jakarta, Pekanbaru, Bandung, Surabaya and Makassar to cater the whole of Indonesia.

By 2008, the DGT, in addition to headquarters, was composed of 31 regional tax offices, 3 large taxpayer offices, 28 medium taxpayer offices, 299 small taxpayer offices, and 207 adjunct taxation and consultation offices. Table 4.4, describes the annual progress in "modernizing" tax offices between 2002 and 2008 as reported by the tax authority.

TABLE 4.4: *Number of Tax Administration Offices at Level II and III (2002-2008)*

	Type of Office	2002	2003	2004	2005	2006	2007	2008
Level II	Regional Offices (Non-modern)	18	22	28	27	11	9	0
	Regional Offices (Modern)	1	2	3	4	20	22	31
	Total Level II (Total non-modern and modern)	19	24	31	31	31	31	31
Level III	District Tax Service Offices	173	168	157	157	157	63	0
	Land and Building Tax Offices	141	146	166	164	164	85	0
	Tax Audit and Investigation Offices	55	53	53	51	51	23	0
	Large Taxpayer Offices	2	2	2	2	3	3	3
	Medium Taxpayer Offices	0	10	11	12	28	28	28

<sup>105</sup> The number of taxpayers registered at a STO varies to a large degree, e.g. KPP Pratama Ponogoro reported 30.000, while Balikpapan reported 124.000, and South Bekasi reported 260.000 clients (Information from DGT).

Level III - Representatives	Small Taxpayer Offices	0	0	15	15	15	171	299
	Total Level III	371	379	404	401	418	373	330
	Taxation Counselling and Information Offices	236	236	236	236	236	143	0
	Taxation and Consultation Offices	0	0	0	0	0	30	207
	Total Level III-Representatives	236	236	236	236	236	173	207
Total	Level II and Level III Total Number of Offices	626	639	671	668	685	577	568

<sup>a</sup> White rows refer to non-modern offices (see Chapter 4.3.1); while light grey shading refers to modernised offices, and dark grey shading describes the total of offices at a particular level in a given year.

Source: Directorate General of Taxes, Annual Reports 2002-2009.

By 2011, the DGT consisted of 583 organisational units. The breakdown follows both geographical and population density requirements: Bali 13, Java 250, Kalimantan 57, Nusa Tenggara 23, Papua Maluku 23, Sulawesi 65, and Sumatra 152 (DGT 2011a: 2).

### *Human Resources Management*

Apart from change management related human resources management reforms, described in Chapter 4.4.3, the DGT implemented reforms to strengthen the quality of its staff. Transformation of HR management from a seniority-based type of management to a competency-based type of management has been a core objective. To achieve this, the DGT took stock of the positions the DGT offered and who was employed at the tax authority. In 2007, the DGT carried out job evaluations and workload analyses based on the complexity of work, overall responsibilities and the specific skills and competencies required. It classified jobs and drafted job descriptions for 2,498 positions, 398 thereof structural and 2,100 functional (MoF 2008b: 12).

At the same time, the DGT started upgrading their human resources management information systems (SIMPEG and SIKKA) to be integrated and include information on age, educational background, and competences of tax officials. This should enable managers to take better-informed decisions for strategic staff planning.

Further, key performance indicators were drafted to provide the basis for objective performance management and the subsequent implementation of a balanced scorecard system. To underline the changed paradigm the Ministry of Finance renamed its personnel directorates, sections and divisions from “employee affairs” [*kepegawaian*], stressing the administrative aspect, to “human resources” [*sumber daya manusia*], stressing the strategic planning aspect.

Recruitment of tax officials has been strengthened. The DGT no longer accepts direct appointment of individuals who completed high school only, while the search for qualified candidates was intensified. In 2008, 1.200 university graduates were recruited for the DGT alone. In subsequent recruitments the DGT received further large allocations. By 2014, it planned to have manpower of 40.000 tax officials (K 29.10.2010). The Ministry of Finance hired reputed universities, such as the University of Indonesia, as independent consultants to get involved in the selection of new employees.

Vacancies are publicly announced via print and electronic media. Registration of candidates is conducted online via a dedicated website, while application forms and documents in hardcopies have to be submitted to the finance ministry's secretariat general in Jakarta. The selection process comprises five stages: initial administrative screening in Jakarta, a written academic potential test at various test locations, psychological test, health assessment and interview. Test results of each selection stage are published online and in print at the bulletin boards of local Ministry of Finance branch offices at test locations. Only candidates who have past the previous stage can proceed to the next stage.

A member of the bureaucratic reform team maintained that following reforms the selection process has become 99.9% clean and more competitive. Of 120.000 applicants registered in 2008, only 1.900 passed, in 2009, 80.000 applied and 2.000 were accepted. The same year Finance Minister Sri Mulyani Indrawati came out to the press claiming that relatives of herself, Darmin Nasution, and the MoF's Inspector General took part in the selection process, yet not one managed to pass beyond the health assessment and interview stages, aiming to prove that relations no longer influenced who was appointed (K 01.06.2009). In how far the public believed this story is not clear. Table 4.5 depicts the DGT's trend towards creating a higher educated staff body.

TABLE 4.5: *DGT Staff based on Educational Attainment Level (2002-2011)*

	2002	2003	2005	2007	2008	2011
Primary School	594	571	507	356	355	133
Middle School	829	786	709	481	334	148
High School	10.285	10.027	8.937	7.311	5.840	4.783
Diploma I	8.955	10.143	4.342	5.547	5.544	4.638
Diploma III			7.160	7.025	5.160	7.129
Diploma IV / B.A.	6.935	6.857	6.375	8.072	9.437	11.439
M.A.	893	935	1.254	2.415	3.595	4.126
Doctorate	8	7	9	22	28	39
Other					201	
Total	28.499	29.326	29.293	31.229	30.494	32.435

<sup>a</sup> In 2002 and 2003, Diploma III category was merged with Diploma I category. Due to weaknesses in the DGT's database, older breakdowns are not available.

Source: Author's compilation based on data from DGT Annual Reports 2002-2009 and DGT (2011a).

Rotation and promotion similarly have been targeted for creating more transparency.<sup>106</sup> The formulated goal has been to put “the right man on the right position”. By 2007, the DGT introduced assessment centers to provide for objective indicators based on three defined competence clusters: thinking, working, and relating. When gaps between job demands and employee capacities were detected, those individuals should receive appropriate training.

For these purposes, the training facilities of the Tax Education and Training Unit were expanded. By 2009, Pusdiklat Pajak had 26 staff members, including 12 *widyaiswara* instructors, often drawn from the ranks of retired echelon I and II tax officials. With the number of classrooms and dormitories raised, Pusdiklat Pajak increased its accommodation capacity to 183 people by 2011. This figure came up from 147 people in 2010 and 40 people in 2009 (MoF 2010). Most trainings last five days, others take 10 days and the longest is scheduled for 37 days. The annual number of tax officials trained at Pusdiklat Pajak climbed from 1.144 in 2002 to 2.725 in 2009, and is planned to be increased further to meet the apparent training needs of tax officials in the long-run (Pusdiklat Pajak 2010).

### *Business Processes Improvement*

Increasing transparency, streamlining, and simplifying business processes were central to DGT's reforms to achieve less discretionary room, more efficiency, and higher public trust. Thus in 2007, the DGT introduced standard operating procedures (SOP) for common business processes. SOPs define a process, refer to the legal bases, and explain who is involved, where, when and how the process should be conducted and what the output should be. Clear targets and costs, if any, involved were defined and accompanied with administrative requirements and flowcharts publicly distributed (see for instance MoF 2009: 74-100). Initially eight SOPs, extended to sixteen by 2010, were picked as DGT's “excellent services” [*layanan unggulan*].<sup>107</sup> They include taxpayer registration, the confirmation of taxable employers, and value-added tax refund services. As these processes occur frequently, they hold potential to shape taxpayers' experience with and perception of the tax authority. Thus establishing transparency in these services was perceived important for generating quick wins.

Tax base broadening efforts by registering new taxpayers also took large room in DGT's reform strategy. From 2008 until February 2009, the DGT implemented Article 37a of Law No. 28/2007 on General Rules and Procedures for Taxation, the so-called “Sunset-Policy”. The policy was valid for micro, small, and medium enterprises, as well as individual taxpayers who voluntarily applied for a taxpayer identification number and

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<sup>106</sup> By 2011, the geographic distribution of tax officials in percent was: Bali 2.1, Java 66.6, Kalimantan 5.4, Nusa Tenggara 2.3, Papua Maluku 2.0, Sulawesi 6.1, and Sumatera 15.5 (DGT 2011a: 5). This distribution corresponds largely with the share of gross regional domestic products by region (see Statistics Indonesia 2011).

<sup>107</sup> By 2009, the Ministry of Finance overall had formulated 6.820 SOPs, of which 35 were chosen for its excellent services priority programme, which involved six of its directorate generals (MoF 2009: ii).



filed annual income tax returns for 2007 and previous years within that period. Further already registered taxpayers who wanted to revise their annual income tax returns for 2006 and previous years were allowed to use the policy. A form of tax amnesty, Sunset Policy offered the waiver of administrative charges and interest penalties in respect of all underpaid tax liabilities, and promised that tax returns were not audited unless the return indicated overpayment or there was strong information indicating that the return was incorrect (DGT 2008c). Until 2010 additional benefits of having a NPWP included: exemption from departure tax, Rp 2.5 million at airports for travelling overseas, a discount of 20% on withholding taxes, and upon the initiative of private enterprises, such as hotels, shops and clubs, discounts on goods and services purchased.

In September 2011, the DGT launched the National Tax Census [*SPN, Sensus Pajak Nasional*], involving 3.000 (honorarium) staff members nationwide, to identify further taxable companies and individuals in economic centres, business centres, high rise buildings, and premium residential areas. In 2012, the Census was ongoing.

DGT also started to better align audits with related risks. For this purpose, it has carried out mapping, profiling and benchmarking exercises to assess profitability ratios of more than 30 industry and business services sectors in order to determine the reasonable amount of taxes companies of a certain profile in a certain sectors should pay. The calculated taxation potential then shall be compared with actual tax payments, and in case of underpayment lead to investigations. By integrating these data in the DGT's information technology system and running automated algorithms, tax evasion is targeted to be minimised and tax manipulations to be detected easier. Yet, the overall progress of developing a computerised tax administration in Indonesia, which is a corner stone in the DGT's business processes improvement strategy, has been slow. The Project for Indonesian Tax Administration Reform (PINTAR), running from 2009-2015 is expected to bring the needed change and improvement.

The previous discussions illustrated that the Indonesian tax authority has undertaken considerable efforts to improve its operations. These comprise reforms in three dimensions: organisational restructuring, human resources management and business processes improvement. Reforms were piloted first and then systematically carried forward over an extended period of time. This gave focus, created consistency, and allowed for projects to be completed. Much of the reforms have been foundation building; they provide adequate grounds for the DGT to build upon.

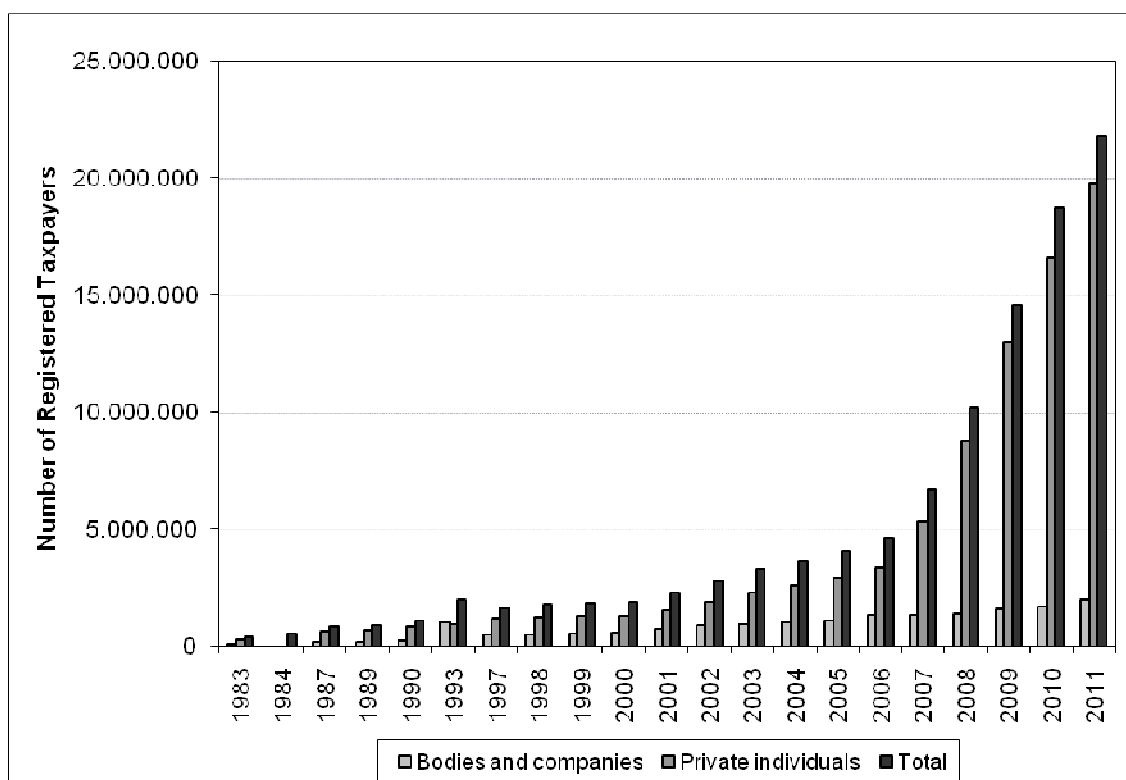
## **4.5 Indicative Outcomes of Reform**

### **4.5.1 Revenue Performance**

With the discussed tax administration reforms still ongoing it is too early for conclusive evaluation. Yet, as Phase I has been completed by 2009, it is possible to identify at least first indications about the impact of reform initiatives on DGT's performance. The following sections will show that the tax authority overall has made progress, yet has significant work left to do.

As depicted in Figure 4.8, Sunset Policy was highly successful in registering taxpayers. When Indonesia started tax administration reforms in 2002, from a population of 210 million less than 2.8 million were registered as corporate or individual taxpayers with the DGT. Until December 31<sup>st</sup> 2008, the original end date of the policy, the number of registered taxpayers had increased to 10 million. The largest annual increase was achieved in 2009, with more than 5 million newly registered taxpayers. In 2011/2 a canvassing programme called the National Tax Census brought in more registered taxpayers. By 2011, the total number of registered taxpayers had increased to 21.8 million; 19.9 million individual and 1.9 million corporate registered taxpayers.

FIGURE 4.8: *Registered Corporate and Individual Income Taxpayers (1983-2011)*



<sup>a</sup> In Indonesia it is possible to register under one NPWP as a family/household, thus the number of registered taxpayers does not equal the number of individuals effectively registered. Recent statistics show that about 30% of all women are employed in the formal sector. International data comparability therefore is restricted.

Sources: World Bank (1991: 49), Das-Gupta (1998: 415), DGT Annual Reports 2002-2011.

On first sight, these developments appear very positive, yet a closer look taints this initial impression. There are two main issues which deserve consideration: first, considering Indonesia's large population, there is still a large potential to be tapped, and second, it is questionable whether the new registrants really brought in new taxpayers.

Statistics reveal that by 2011, of Indonesia's 240 million inhabitants, 110 million actively worked, 60 million thereof earned an income higher than the tax exemption threshold, yet only 19.9 million were registered taxpayers and only 8.8 million filed

their tax returns. Of Indonesia's 22.6 million formally registered midsize or large corporations, 12.9 million were active and 5 million estimated to have capital large enough to pay taxes, yet only 1.9 million were registered taxpayers and 520 thousand finally filed a tax return (DGT 2012c: 5). The Indonesian authorities are aware of these disparities and expressed the intention to further work on broadening their tax base.

Just increasing the number of registered taxpayers however is hardly effective as experience has shown. There are indications that in the course of Sunset Policy the majority of newly registered taxpayers have been formally employed individuals whose taxes have been subject to withholding already, low-income individuals as well as small and medium enterprises whose income was close above or even under the taxable threshold (K 26.08.2009). Already by nature, these taxpayers will hardly contribute to an increase in tax revenues. Even more, being a registered taxpayer does not equal being an effective taxpayer. In fact, some individuals, the author informally talked to, admitted to have registered with the DGT only to benefit from the advantages of having a taxpayer registration number offered at that time. They never had the intention to pay taxes. This suggests that Indonesia's tax effort, the ratio of actual revenues to potential, remained stable. And indeed, Table 4.6 demonstrates that Indonesia's DGT-collections-based total tax ratio continues to rank well below the average for developing countries.

TABLE 4.6: *Revenue Performance Indicators, Indonesia (FY 1996/97 – FY 2010/11)*

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total	9.0	8.9	8.6	8.6	7.9	8.2	8.7	9.0	9.4	9.5	9.4	10.7	11.5	9.7	9.8
Income	4.9	4.9	5.5	5.3	4.2	4.3	4.6	4.7	4.9	5.1	5.0	6.0	6.6	5.7	5.6
VAT & Luxury	3.6	3.5	2.7	2.9	3.2	3.4	3.6	3.7	3.8	3.7	3.7	3.9	4.2	3.5	3.6
VAT	3.2	3.2	2.6	2.7	2.8	3.0	3.3	3.5	3.5	3.4	3.5	-	-	-	-
Land	0.4	0.4	0.3	0.4	0.4	0.4	0.4	0.5	0.6	0.7	0.7	0.8	0.6	0.6	0.6
Other	0.1	0.1	0.0	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.1	0.0	0.1	0.0	0.0
TRCR	44.7	41.5	37.8	35.4	35.1	35.9	38.0	35.0	34.0	33.5	30.4	28.6	31.0	52.6	54.8
COCR	0.51	0.50	0.27	0.34	0.34	0.38	0.58	0.45	0.45	0.44	0.40	0.57	0.56	-	-

<sup>a</sup> Tax revenues, according to the Indonesian government's definition, are presented as percentage of GDP. As only domestic national level taxes collected by the DGT are considered, the total percentage should be lower than tax ratios listed in other sources, but more accurate for capturing the likely influence of tax administration reforms. Data comparability is restricted. Calculations of data for 2009 are based on preliminary, for 2010 on very preliminary GDP figures.

<sup>b</sup> The annual income tax return compliance ratio (TRCR) is calculated both on individual and corporate taxpayers' tax return submission. Figures show only the formal compliance, they neither show in how far taxpayers reported the truth nor the tax authority's capability of collecting reasonable liabilities.

<sup>c</sup> The cost of collection ratio (COCR) is calculated based on a calculation of administrative costs incurred to revenues collected. As there are many factors that can influence the ratio, and it ignores revenue potential, it needs to be interpreted with special care.

*Sources:* Tax revenue data for 1996-2006 taken from Brondolo (2008: 10, 39), for 2007-2010 author's calculation based on Statistics Indonesia (2012a; 2012b). TRCR and COCR calculated with data from Setiyaji/Amir (2005: 10), DGT Annual Reports, and Statistics Indonesia.

Nevertheless, when analysing the development trend, the overall performance does not fare too badly. Since the beginning of the discussed tax administration reforms in fiscal year 2001/02, a steady, albeit modest, increase of total domestic tax revenues averaging at 0.5 percentage points annually, can be registered. Total revenues peaked at 11.5% in 2008. Income tax revenues, levied both on businesses, corporations, and individuals, increased concomitantly, from 4.2% in 2000 to 6.6% in 2008. Value-added tax & luxury sales tax revenues remained comparatively stable, while land & building tax revenues followed a slightly positive trend. Only in 2009, tax revenues overall declined, before stagnating at a total of just about 10%. In 2003, LTOs contributed 22% of total DGT tax collections (DGT AR 2003: 19). The following years, LTOs' share initially increased, reaching a high of 50% in 2007, before dropping to 42% in 2011 (DGT 2012b). In absolute terms, during the period under observation, tax revenues climbed from Rp 135.6 trillion in 2001/2 to Rp 628.2 trillion in 2010/11.

Due to the complexity of factors, it is extraordinarily difficult, if not impossible, to determine exactly which particular factors were responsible for the increase and later decline of tax collections. Yet, with politico-economic knowledge we can at least attribute certain developments to certain events. For instance, the increase of total revenues is most likely related to the country's sustained economic growth and arguably a more effective tax administration.<sup>108</sup> DGT's better performance appears most visible in the growth of income tax and land & building tax revenues. The reason is, that direct taxes, which involve direct payment from the taxpayer to government, tend to be more difficult to impose and collect than indirect taxes, such as the VAT, hence their positive development may indicate more efficient tax mobilization. This interpretation is backed by the annual income tax returns compliance ratio, which increased significantly in the last few years. The cost-of-collection ratio for the case of Indonesia's tax administration does not provide reliable information as to whether the DGT has become more effective and efficient or not. That said, if correct, being particularly low, the ratio may point on a low budget, and thus a potential under-funding of the tax administration by government. The revenue slump in 2009, on the other hand, is most likely to be related to the global economic downturn, which depressed Indonesia's economic growth and affected its labour market negatively, effectively shrinking the tax base. Further, the Rp 71.3 trillion fiscal stimulus package government introduced in response, consisting to about 75% of tax cuts for companies, workers and individuals, caused tax revenues to fall (Munandar/Simorangkir 2011).

It remains to be seen, whether the revenue dip was more the result of the global financial crisis or the result of DGT's inability to sustain revenue growth, which is typical of many reforming tax authorities, in the mid- to- long run. While some progress

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<sup>108</sup> There are numerous other possible factors influencing the tax revenue, yet in comparison their impact seems less relevant to explaining the development. For instance tax policy has been stable in the last decade; changes were relatively limited and concerned few taxes only (Brondolo 2008: 37). They may however be relevant in partly explaining why revenues are low. E.g. a number of Indonesian standard tax rates are lower than or at the lower end of neighbouring countries rates (Benedek 2011: 23-31).

has been made, what is obvious is that Indonesia is still far from achieving its declared overall medium-tax target of 18% of GDP.

#### 4.5.2 Taxpayer Attitude and Opinion

The DGT with regard to taxpayer attitude and opinion has experienced ups and downs. Been detested for decades, by the time the author conducted the central interviews for this study in 2009, the DGT had managed to improve its image. Not only international advisors were enthusiastic about what was happening at the tax office,<sup>109</sup> but also entrepreneurs, business functionaries, and private individuals interviewed were optimistic as they perceived better service and treatment. Several largely independent taxpayer surveys carried out in recent years show that these views were representative.

In 2005 and 2007, the DGT, with AusAID sponsoring, hired AC Nielsen to measure taxpayers' satisfaction with the tax authority's modernised tax offices. Based on its Customer eQ approach, in 2005, the marketing research firm approached about half of the taxpayers registered with LTOs to ask them detailed questions about their perception of the new offices. Results turned out to be favorable. The LTO scored an overall performance rating of 81, indicating a high level of taxpayer satisfaction.<sup>110</sup> Among the survey's respondents, 84% reported that tax fulfillment has become easier since LTOs were established, 78% reported significant changes in tax officers' behaviour. LTO's comparative strengths, the survey revealed, lie in its professional integrity, the simplicity and efficiency of the tax compliance process, taxpayer services and information resources provided. Taxpayers' satisfaction was the highest with the filing, payment and refund management functions, and lowest with audit and objections. Similar positive results emerged from a survey of the DGT's Special Regional Tax Office (Brondolo 2008: 48f; Pandiangan 2008: 59-62). In 2007, the satisfaction of taxpayers registered at STOs was measured. Results were not as favorable, but encouraging. The weighted average satisfaction score of individual and corporate taxpayers reached 74 each, and that of property taxpayers 70 (DGT 2008d).

In 2007 and 2008, University of Indonesia carried out surveys to monitor and evaluate the satisfaction of individuals using the services of the Ministry of Finance. Overall, the degree of satisfaction had increased. With regard to the DGT, in 2007, 6.4% of respondents expressed that they were not satisfied, 30.8% that they were quite satisfied, and 62.8 that they were satisfied. In comparison, by 2008 the percentage of respondents unsatisfied fell to 5.1 and of those quite satisfied to 19.6%, while the percentage of satisfied respondents climbed to 75.3% (DGT 2009c).

What these surveys however missed out, has been to inquire about taxpayers' attitudes and opinions at 'ordinary' tax offices in the regions. There are indications that reform

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<sup>109</sup> One advisor interviewed was even drawn to declare DGT's reform the most vibrant he had experienced in the last two decades. Yet, he was also cautious enough to express his concern about its sustainability.

<sup>110</sup> The rating is up to 10 points higher than the results of comparable public sector surveys in Australia, Hongkong, India, and Singapore.

has only touched offices in Jakarta, at best Java. The further away and the less important the office, the less these offices and their employees have changed. The major concern of all stakeholders involved, including tax officials, has been that the DGT so far has only managed to change its structures but not its bureaucratic culture.

The tax administration today is getting very modern because of the progress, the computerization, the registration numbers, but still it's build on old values (Interview: Business Representative).

Personally, I do not see any significant change at the Ministry of Finance yet. There are still illegal fees, corruption is still happening. I do not see that the reforms have changed the public service culture (Interview: Social Scientist).

I don't believe that the way they reform the tax office is sufficient to do a real reform. A lot of them are gimmick. The reform is essentially just a small increase of salary (Interview: Politician).

Since 2010, these pessimistic opinions turned increasingly cynical and became increasingly widespread, as more and more cases of corrupt tax officials surfaced. Table 4.7 summarizes the two cases that triggered the strongest public reactions. In 2012, many stakeholders even referred to the first, Gayus Tambunan, as a "demarcation point"; there is a before-Gayus and an after-Gayus in Indonesian tax administration reforms.

TABLE 4.7: *Selected High Profile Tax Corruption Cases, Indonesia (2010-2011)*

Verdict	Name, Age at Sentence, Position	Case
2010	Gayus Halomoan Tambunan (31 years)	Gayus Tambunan has been Indonesia's most high-profile case, implicating senior tax officials, police officers, prosecutors, and lawyers.
	2000: Start of career as tax official	In 03/10 investigations in his case started. This followed the disclosure that PPATK had found suspicious transactions worth Rp 28 billion in Gayus's bank accounts. He had been alleged also of owning thousands of dollars worth of properties and other fixed assets. Later investigations found about Rp 100 billion in his bank accounts. Gayus testified to have brokered taxes for at least 44 companies, including firms related to Aburizal Bakrie.
	2007: Tax Objections Officer, Golongan III a,	His monthly salary accounted to Rp 12 million.
	Directorate for Tax Objections and Appeals, DGT HQs	On first instance, Tangerang District Court acquitted Gayus of money laundering and corruption charges. Gayus later declared he had paid the judges US\$ 40.000 for the acquittal. While in detention Gayus bribed prison wardens and guards at National Police's Mobile Brigade detention facility in Depok to be allowed out temporarily. Within four months he admitted to have left prison at least 68 times, among others he made trips to Bali, Macau, Kuala Lumpur and Singapore on a forged passport he had obtained from an agent.
		Until July 2012, in five trials before different courts Gayus, was convicted to a total of 30 years imprisonment on five counts – accepting bribes, failing to report gratuities, committing money laundering, bribery of the police and prosecutors, and document forgery.
		At least Rp 84 billion were confiscated by the state.
		Reportedly imprisoned at Sukamiskin Penitentiary, Bandung, West Java.

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2011	Bahasyim Assifie (58 years)	According to the indictment Bahaysim collected at least Rp 60 billion plus US\$ 681 thousand by misusing his position and authority as a civil servant between 2002 and 2009. Bahaysim is said to possess at least five luxury houses in several Jakarta districts. Allegedly, he received regular payments for tax brokering. Among others, he is said to have accepted a Rp 1 billion bribe from business tycoon Kartini Mulyadi in 2005.
	2002-2008: Several positions in Jakarta Tax Office VII (Koja and Palmerah area), Echelon III	Bahaysim stated possession of only Rp 10 billion in his official wealth report to the KPK. His monthly salary accounted to Rp 20 to 30 million.
	2002: Director of Tax Examinations and Investigations	PPATK found suspicious transactions in bank accounts belonging to his wife and two children.
	2008: moved to Bappenas	Prosecutors recommended a term of 15 years in 02/2011.
		Sentenced to six years imprisonment and a fine of Rp 500 million each for corruption and money laundering, that is twelve years and Rp 1 billion in total by the Supreme Court in 10/11.
		Rp 67 billion scheduled to be transferred to the state's account in 05/12.
		Reportedly imprisoned at Sukamiskin Penitentiary, Bandung, West Java

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<sup>a</sup> Further high-profile cases of tax officials sentenced to imprisonment for corruption and money laundering is in Appendix I.

*Sources:* Mahkamah Agung (2011b; c); JG 27.07.2010, 07.01.2011, 02.02.2011, 27.05.2011; JP 19.08.2010, 15.11.2010; KT 02.05.2012, 06.07.2012, 28.12.2012.

While previously the DGT was perceived as being on the right track, following these high profile corruption cases, critical taxpayers feared that all was back to 'business as usual'. A storm of public outrage broke out against the scandals. Sharp caricatures were printed in newspapers, demonstrations were organised, and Facebook groups against paying taxes initiated (VN 01.04.2010). A song by a former convict criticising the dismal state of the legal system, by example of Gayus Tambunan who successfully bribed prosecutors and prison wardens, was played frequently on radio and TV stations nationwide. Bus conductors passing by DGT headquarters made it a habit to announce "Gayus, Gayus" instead of the real name when they approached the closest bus stop. In the aftermath the term "Gayusisme", describing a syndrome of greediness among civil servants entered the Indonesian colloquial speech.

Both tax officials and taxpayers stated that they lost confidence in what is achievable. Yet, viewed objectively, even if the recent exposure of corrupt tax officials indicates that the DGT has not made as much progress as was hoped, it suggests that the DGT has achieved something. Prior to reforms it was an open secret that the tax authority and taxpayers collude; and many tax officials and taxpayers accepted it as a given. This perception has changed. Moreover nowadays discomfort with tax manipulations can be expressed in public. Something that was unthinkable of earlier. In itself it is an achievement. The coming years will have to show whether we experienced a case of backsliding or rather a case of progress in disguise.

## 4.6 Conclusion: Indonesia Case Study

This chapter provided a detailed politico-economic analysis of taxation in Indonesia and gave a cohesive and nuanced narrative of the 2000s Directorate General of Taxes' reforms. The case study evidence indicates that Indonesia has been a vivid example of a country which considers raising domestic revenues only when the need arises and is then able to find the necessary leverage to create reform space and push for reforms.

Process-tracing indicates instances of path dependence. These are relevant for understanding the shortcomings and weaknesses of taxation and the challenges to and chances of reforming the tax administration in Indonesia. Five critical junctures stood out: Indonesia's independence, Soeharto's presidency, the decline of the oil-boom, crisis-triggered democratisation, and the re-election of President Yudhoyono.

Long after independence, the colonial regime's influence on the set-up and practices of public administration in general and taxation in particular remained visible. Pursuing largely extractive strategic objectives the Dutch colonial power had left Indonesia with a weak public administration system, ineffective tax system, and an excessively cynical attitude of Indonesian citizens towards taxation. It is obvious that the tax administration shares similar weaknesses to the entire public administration system.

During Soeharto's presidency the DGT also became a location and a means to provide cronies and those loyal to the regime with favours in exchange for their support. Collusive practises in tax policy making and tax administration affected revenue collections. Overall the influence has been on a general level however, elite interference in the day-to-day operations of the tax authority was reportedly a rare incidence. It was Soeharto only whose control of the bureaucracy was strong; the bureaucracy remained comparatively independent from the country's economic elites.

For decades, domestic revenues contributed little to the state budget. As long as non-tax revenues sufficed to finance the state a condition rarely discussed. Only in the 1980s, a first set of significant tax policy reforms were introduced by a Soeharto-appointed technocrat financial management team. Declining non-tax revenues had to be offset. While in subsequent years overall revenue collections increased, the tax base remained small and tax legislation retained numerous loopholes which gave tax officers room for discretion and taxpayers opportunities for negotiations. The tax administration, neither structured nor staffed adequately, was not designed to promote effective, efficient and equitable taxation. Rather, it provided fertile ground for tax avoidance, tax corruption, and tax evasion at the expense of the state budget.

Data collection and data processing for tax purposes were seriously flawed; data was not only missing, but unreliable and hardly exchanged. Different types of taxes were administered by different tax offices; it was impossible to gain a full picture of a taxpayer's payments and liabilities. The tax burden fell excessively on withholding taxpayers; both professionals and those in the informal sector were rarely captured. Public opinion surveys and informed estimates indicate that tax corruption and tax evasion have been rampant. Both external and internal accountability mechanisms were



of little effect. This situation was widely accepted, radical reforms were not in the interest of most Indonesians both outside the tax administration and within the tax administration. Hence, for decades it was left unchanged.

It were only the severe impacts of the Asian financial crisis in 1997/8 on the Indonesian economy, which forced the Government of Indonesia to request international assistance and the subsequent pressures from the International Monetary Fund which led to the introduction of tax administration reforms. Initially, enthusiasm for reforms was low. Yet, as long as the reform measures were unlikely to seriously threaten vested interests they were accepted. A general sense of a strengthened tax system's common benefits seemed to exist among the country's decision-makers. The creation of a large taxpayers office preceded all other steps. LTO staff was selected based on their qualifications and integrity; upon their transfer to the LTO they received higher salaries than their colleagues based at other tax offices. Initially, the large taxpayers were selected exclusively from already registered corporate taxpayers. The remainder of the tax administration, with all its issues, was left largely untouched until 2005.

Then, presidential commitment to reform and the appointment of reform-minded technocrats to the country's financial management team gave tax administration reforms a boost. The Finance Minister was perceived as the architect and the Director-General of Taxes as the steering wheel of reforms. Together with the transformation directors they formed a strong leadership team. International donors gave advice and provided technical and financial support. Parliament passed the required counterpart funding and the additional financial means to raise the salaries of finance officials. The Minister of Finance had regarded this as essential to gain tax officials' cooperation in reforming the tax authority. Also the Ministry for the State Apparatus and Bureaucracy Reform cooperated in granting the Ministry of Finance and its attached agencies the status of pilot agencies for bureaucracy reforms. While the DGT was still constrained in the shape and degree of its reforms by the wider public administration system, its special status gave leeway to build around these constraints. Both ownership and leadership have been in the hands of the Indonesian government.

Overall change management was sensible and the reform strategy reasonable. Stability of the office holders has been a critical factor as this allowed for continuity in project implementation. Reform measures that were piloted and whose outcome was assessed satisfactory could be rolled out nationwide. By introducing significant reforms to the Directorate General of Taxes' organisational structure, its human resources management, and business processes, the Indonesian government was able to lay the foundations for a better tax system and increased tax revenue collections. Opportunities for tax evasion were curtailed and the risks of tax evasion raised. Tax corruption cases for the first time were investigated seriously and taken to the courts. Tax officials had to gain the perception that they had to change and the public the perception of a tax authority that has changed both internally and in relations to the public.

The speed and radical nature of reforms gained Indonesia praise amongst observers and instilled interest of the general public in tax matters, but also evoked resistance among

Indonesia's economic elites who felt that their vested interests were increasingly threatened. A high profile bailout controversy and political backroom negotiations caused the Finance Minister to resign by mid-2010. Her ally Director-General had already retired and been replaced by a less radical, yet also reform-oriented senior career tax official, in mid-2009. The Finance Minister's successor remained in his position until mid-2013, when he was appointed Governor of Bank Indonesia, and the Director-General until he retired. While reforms continued under the new financial management, they lost in drive. Under pressure the executive had to succumb to vested interests. This shows that reforms are bound by political feasibility. Clearly, following democratisation economic elite influence of politics and bureaucracy had grown. Yet, both still remain far from being captured.

## **5 Case Study: The Philippines' Bureau of Internal Revenue**

The Republic of the Philippines consists of 7,100 islands. It stretches 1,850 km from north to south, and 1,600 km from east to west. Its land area covers 300,000 km<sup>2</sup>. The Philippines has a population of 94 million; 11 million live overseas. It is divided into three major island groups: Luzon, Visayas, and Mindanao. Manila, the Philippines' capital city, is located on the island of Luzon. By 2011, the country was divided into 17 regions, 80 provinces, 138 cities, 1,496 municipalities, and 42,026 villages. Luzon is the most densely populated Philippine island, being home to more than 50% of the population. It constitutes the country's economic heart, contributing about 66% of the gross domestic product; the National Capital Region alone has a share of 37%. Mindanao follows with 18%, while the Visayas contribute the remaining 16% (National Statistics Coordination Board data). Fragmentation presents a challenge to the country's efforts of implementing change; yet based on geography overall it should be a less arduous task for the Philippines, than for its larger neighbour Indonesia.

### **5.1 Introduction**

The Philippines' Bureau of Internal Revenue, the BIR, has a long tradition of reforms. Its most recent reforms were initiated in year 2001. The case study aims to shed light into the political economy of these reforms. Similar to the Indonesia case study, the main goals are to understand why the BIR's tax collection performance for decades has been below expectations, how the reforms proceeded, what impact they had and why they proceeded as they did. The chapter is organized into five main sections: first it describes the national context of reform, second the administrative conditions of reform, third the process of reform, fourth the indicative outcomes of reform, and finally a concluding section synthesises the main findings of the case study.

### **5.2 National Context of Reform**

#### **5.2.1 Neopatrimonial Profile**

Between 1965 and today, the Philippines experienced two distinct regime periods: the Marcos administration (1965 to 1986) and democratic government (1986 until today). Since 1986, the Philippines experienced five presidents: Corazon Cojuangco Aquino (1986-1992), Fidel Valdez Ramos (1992-1998), Joseph Ejercito Estrada (1998-2001), Gloria Macapagal-Arroyo (2001-2010), and Benigno Aquino III (2010-present). The analysis of neopatrimonialism's three dimensions indicates that the Philippines during both periods was a neopatrimonial state par excellence.

*Concentration of Power*

Ferdinand Marcos (1965-1986), previously lawyer and member of the House of Representatives (1949-1959) and the Senate (1959-1965), was elected president in 1965 and 1969. He promised to promote economic growth, and end corruption and cronyism. The Philippines hardly progressed though. Rather, Marcos's government turned increasingly centralised and directed towards his own personal benefit. The culmination point was 1972, when Marcos imposed Martial Law and introduced "constitutional authoritarianism".

Officially, the objective was to meet looming crisis from economic downturn, natural calamities, leftist rebellion, and rightist conspiracy against the Republic. Through establishment of a "New Society", Marcos declared to "save the republic and reform society" (Presidential Proclamation 1081). In hindsight, the introduction of Martial Law seemed more like Marcos's strategy to retain power, circumventing the constitutional prohibition to serve longer than eight consecutive years (Brillantes 1987).

Marcos tried to give his government the appearance of legitimacy; he ensured that whatever he did was "legal". However, it was not an independent commission that set the standards, but Marcos himself, who had set himself up as the ultimate authority. Within a year, he dissolved the Congress, conferred vast powers to govern the nation upon himself, passed a new constitution, and suspended the writ of habeas corpus. By legal-engineering he strengthened his influence on almost every aspect of life:

During the course of martial law, Marcos issued 1,941 presidential decrees, 1,331 letters of instruction, and 896 executive orders, leaving his mark on practically every important legal and juridical issue the country faced (Abinales/Amoroso 2005: 207).

Marcos was president, prime minister, and commander-in-chief of the armed forces. He subordinated the Supreme Court and the Interim National Assembly (*Interim Batasang Pambansa, IBP*).<sup>111</sup> His decision sufficed to remove any executive and judicial employee from civil service. Elections and referenda were marred with irregularities, opponents silenced, and the media strictly censored (Abueva 1979: 36-57). Filipinos and international finance institutions increasingly criticised Martial Law; it was lifted in 1981. Afterwards, Marcos had himself "elected" president again. His powers however remained virtually unchanged. Decision-making continued to be less a matter of cabinet discussions, legislative deliberations, or independent judicial review, but of Marcos's personal signature.

The analysis of cabinet secretaries' rotation, shows that Marcos's tenure, with 20 years, was significantly longer than the average tenure of key secretaries, with 5.3 years. Secretaries were not rotated regularly. While some departments remained under stable leadership, others experienced frequent change. Marcos balanced between retaining

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<sup>111</sup> The unicameral IBP was 'elected' in 1978; all but 14 of its 187 representatives were members of Marcos's KBL-New Society Movement (*Kilusang Bagong Lipunan*). It did not have any real rights: An independent assemblyman criticised the legislature as "a puppet parliament and a democratic facade for an authoritarian regime". Military men would monitor the utterances of its members (FEER 08.06.1979).

essential control and stability, as the Departments of Defence and Finance suggest, and sharing out patronage benefits, while ensuring that no one became too powerful, as the Departments of Trade and Industry, and of Public Works and Highways indicate.

TABLE 5.1: *Tenure of Presidents and Key Secretaries, Philippines (1965-2010)*

Office	Marcos Era: Number of Incumbents	Marcos Era: Average length of tenure (in years)	Democratic Era: Number of incumbents	Democratic Era: Average length of tenure (in years)
President (ED)	1	20	4	6
Secretary of Defence	2	10	12	2
Secretary of Education	5	4	12	2
Secretary of Finance	2	10	14	1.7
Secretary of Foreign Affairs	4	5	9	2.7
Secretary of Health	4	5	11	2.2
Secretary of the Interior	5	4	13	1.8
Secretary of Justice	8	2.5	12	2
Secretary of Labour	3	6.7	11	2.7
Secretary of Trade and Industry	7	2.9	10	2.4
Secretary of Public Works and Highways	8	2.5	13	1.8
Average of Key Secretaries (CD)		5.3		2.1
Power Concentration Index (ED/CD)		3.8		2.9

<sup>a</sup> Cabinets were included only if 50% or more of the constitutionally defined presidential term had passed by the time of calculation, i.e. 02 January 2012. Therefore cabinets included into the calculation range from 30.12.1965 until 24.02.1986 for the Marcos Era and from 25.02.1986 until 30.06.2010 for the Democratic Era. ED stands for Executive Duration, while CD stands for Cabinet Duration.

<sup>b</sup> Note, that some secretaries, in both periods, were not replaced on the initiative of the president. They resigned for personal reasons, or out of protest to the president's policies, hence had to be replaced.

*Source:* Author's calculation based on data from the Department of National Defence (2010), Department of Education (1998), Department of Finance (2005), Department of Foreign Affairs (2011), Department of Health (2005), Department of the Interior and Local Government (2001), Department of Justice (2010), MT 04.12.2008, Department of Trade and Industry (2008), Department of Public Works and Highways (2008), Macmillan's Statesman's Yearbooks (1986-2010).

In 1983, Marcos was implied in the assassination of his staunchest political opponent, ex-Senator Benigno "Ninoy" Aquino Jr. The assassination unleashed outrage across socio-economic lines. Cory Aquino, the widow of Benigno "Ninoy" Aquino, led the anti-Marcos movement. By 1986, "People Power" mass protests, also known as the EDSA 1 Revolution, led to Ferdinand Marcos's overthrow (see Thompson 1995).

Cory Aquino (1992-1998) came to power as a transitory president on the grounds of her acclaimed victory in the 1986 "snap elections" Marcos had called prior to his overthrow. Filipinos regarded her as charismatic, but criticised her for a lack of administrative and political skills. Several coup attempts threatened Cory Aquino's presidency. The focus of her government centred on the restoration of liberal democratic structures and processes. Here she succeeded: Within a year and a half, Filipinos ratified a new constitution and restored democratic institutions. Under the

1987 Constitution, modelled after the United States' Constitution, the Philippines returned to a bicameral presidential system, separation of powers, and mutual checks and balances. President and vice-president, who run separately, senators, members of the House of Representatives, local chief executives, and local legislators since are directly elected through a first past the post ballot. But Cory Aquino's powers, potentially also her will, were not strong enough to institutionalise any meaningful economic and social reforms. At the end of her constitutional term, Cory Aquino declared she would not seek (re)election.

Fidel Ramos (1992-1998), retired military general, Aquino's chief of staff and Secretary of Defence, won a minority presidency. Yet, subsequent turncoatism gave him a majority in the House of Representatives. In Senate he was less successful. Political observers regard Ramos as one of the Philippines' most effective presidents. Ramos introduced economic liberalization, deregulation, and privatization measures. He served until the end of his term; re-election was prohibited by the new Constitution.

Joseph Estrada (1998-2001), former movie actor and vice-president of his predecessor, based on his mass appeal and his promise to eradicate poverty won a popular vote. Soon, his government however became heavily criticised of alleged corruption and illegal business transactions. Estrada was the first president to be impeached by the House of Representatives and put to trial by the Senate. Yet, before the trial ended, another people power movement, EDSA 2, and the military's withdrawal of support, in 2001, already had forced Estrada to resign.

Gloria Macapagal-Arroyo (2001-2010), economist, resigned vice-president, former Senator, and daughter of former President Diosdado Macapagal, was sworn in to complete the remaining four years of Estrada's presidency.<sup>112</sup> The legitimacy of Arroyo's presidency was controversial at the start, acknowledged for some time, before being increasingly criticised towards the end. Her relationship with the Senate and the House of Representatives was ambivalent. Despite her prior announcement not to seek (re)election, Arroyo not only participated in the 2004 presidential elections, but also was determined to win. Allegedly vote manipulation secured her the extension of the presidency (Verzola 2004; PCIJ 28.-29.07.2004; PCIJ 2005).

Following her re-election, Gloria Arroyo, by pushing the boundaries of the law through assertion of the president's constitutionally implied and residual powers, as well as the over-usage of presidential privileges and immunities, increasingly weakened the legislature and the judiciary, and rendered constitutional checks and balances largely inefficient (Hutchcroft 2008; Rose-Ackerman et al. 2010). Her government suggested introducing a unicameral parliamentary system by "Charter Change". This would have given Arroyo the chance to continue ruling the country, as prime minister. The move was unsuccessful. Hence, towards the end of her term, and following at least four

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<sup>112</sup> Estrada later was found guilty of plunder, yet he hardly served the verdict of imprisonment, as Arroyo gave him full pardon not even two months later. Speculations fuelled, whether the two had made a deal.

impeachment attempts, Arroyo chose to concentrate on securing the representation of her home-district Pampanga in the House.

Benigno Simeon “Noynoy” Aquino III, the son of Cory and Ninoy Aquino, won the subsequent presidential elections on an anti-corruption platform. His claim: *Kung walang corrupt, walang mahirap* [If no one is corrupt, no one will be poor]. Noynoy Aquino has been regarded as reformist; yet it is believed that his election success was related to timing also. His mother passed away nine months prior to the presidential elections; Filipinos' mourning and nostalgia, allowed the public vision of her son as a sincere successor to prosper.

As the analysis of the office of the president already indicates, the Philippines' economic elite “owns” political office, and “bequeathes” positions from one generation to the other. In fact, less than 200 families dominate executives and legislatures nationwide. There is strong evidence for path dependence: Many elite members find their roots in the traditional land-owning oligarchy who consolidated their positions in the 19<sup>th</sup> century; some others in wealthy families who made big business in the manufacturing, services and trade sectors (Anderson 1988; McCoy 1993; Simbulan 2005; PCIJ 2012).<sup>113</sup> The Philippines' most wealthy and powerful clans divide political office amongst each other; this applies not only to the president and the vice-president, but to all national and local positions.

In every Congress, despite the constitutional prohibition of political dynasties, about 60% of representatives are members of political clans (Coronel et al. 2007: 47).<sup>114</sup> Comparing the Senate and the House of Representatives, the Senate is a little more ‘independent’. With Senators elected on a national ballot, members of political clans are challenged by members of the military and the police, as well as celebrities (Coronel et al. 2007: 31f). Members of political dynasties with local power bases, known as traditional politicians (*trapos*, Filipino for dishrag), continue to dominate the House of Representatives. Celebrities from the media, movies, and sports joined the House only more recently. So far, few politicians are progressive-minded. Term limits and the introduction of a party-list scheme for sectoral representation hardly changed the set-up. Politicians circumvent the legal provisions: Congress never passed an anti-dynasty law, hence the constitutional prohibition of political dynasties remains ineffective. Family members, during the same term occupying positions as congress members, governor, and mayor, swap positions when term limits are reached. Further, traditional politicians increasingly acquire seats from party-lists (Kontra Daya 2010, 2012a, 2012b).

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<sup>113</sup> The 1950 U.S. Economic Survey Mission to the Philippines, known as Bell commission, noted that “Land is the most important source of wealth in the Philippines and its concentration or distribution is the primary factor that affects the social and economic well-being of the people” (Bell et al. 1950: 55).

<sup>114</sup> Art. II, Sec. 26. For well researched portraits of some of the Philippines most influential political families see PCIJ (01.03.2007).

What most elected to public office share is considerable wealth.<sup>115</sup> The Statements of Assets, Liabilities and Net Worth (SALN) of the members of the 15<sup>th</sup> Congress (2010-2013) revealed that 224 out of 228 district representatives are from the 0.1% of Filipino families which earn at least P 2.4 million a year. The four individuals who did not make it into the group are also millionaires. “(T)he average net worth of a district representative is about 120 times bigger than the average Filipino family income” (GMAN 27.07.2011).<sup>116</sup> Also, of the 56 party-list representatives all but five reported a net-worth of more than P 1 million (PDI 19.07.2012). Distributions for earlier Congresses are comparable, as the analyses of legislators’ assets from the 9<sup>th</sup> (1992-1995) to the 12<sup>th</sup> (2001-2004) Houses point out. In 1992, only 15 members of the House, and in 2001, 8 members of the House stated assets of less than P 1 million (Coronel et al. 2007: 23). Politicians business interests have tended to be strong and legislation biased towards personal benefits:

... studies generally agree that the exercise of power by local strongmen/women, bosses and families has been in pursuit of selfish ends. ... individuals enshrine themselves in state institutions at the national level with the goal of expanding and protecting the power they have accumulated at the local level (Abinales 2008: 295).

“Political parties are usually no more than clans allied behind economic interests, political exigency, pragmatism, and *utang na loob* (debt of obligation)” (Navarro 1991: 271; cf. Ufen 2008). Party-switching [*turncoatism*] in favour of the party in power of the purse has been commonplace (Landé 1996; Hicken 2009). Regardless of election results, once the term started, thanks to party-switchers, the president’s party tends to hold the majority in the House of Representatives. Opposition forces have always been a small minority. Nevertheless, as party discipline is weak, presidents can never be certain who supports and who challenges their decision-making. Such high degree of particularism encourages politicians to cultivate a personal vote.

In terms of neopatrimonial power concentration the Philippines is a mixed bag. Power is concentrated in a tiny economic elite; democratisation did not change this. As Table 5.1 indicated, democratisation has however reduced the power of the president. POLITY IV’s Executive Constraints Indicator, the World Bank’s Database of Political Institutions (DPI) Indicator Checks, and the Political Constraints Index substantiate this impression. For example, the DPI indicator Checks counts only one veto-player until 1986, but four in the 2000s.

<sup>115</sup> Campaigning costs are high. It is estimated that to win an electoral position the following amounts are needed: president P 3-5 billion, senator P 100-200 million, congressman and provincial governor P 5-50 million, and municipal mayor P 3-20 million (Batalla 2001: 14). These amounts are a multiple of the total official salaries incumbents can earn. With a tenure of six years the president’s salary would amount only to P 4.2 million and a senator’s to P 2.9 million, with three year terms, salaries of a congressman amount to P 1.4 million, of a provincial governor to P 1 million, and of a mayor to P 830 thousand (DBM 2001).

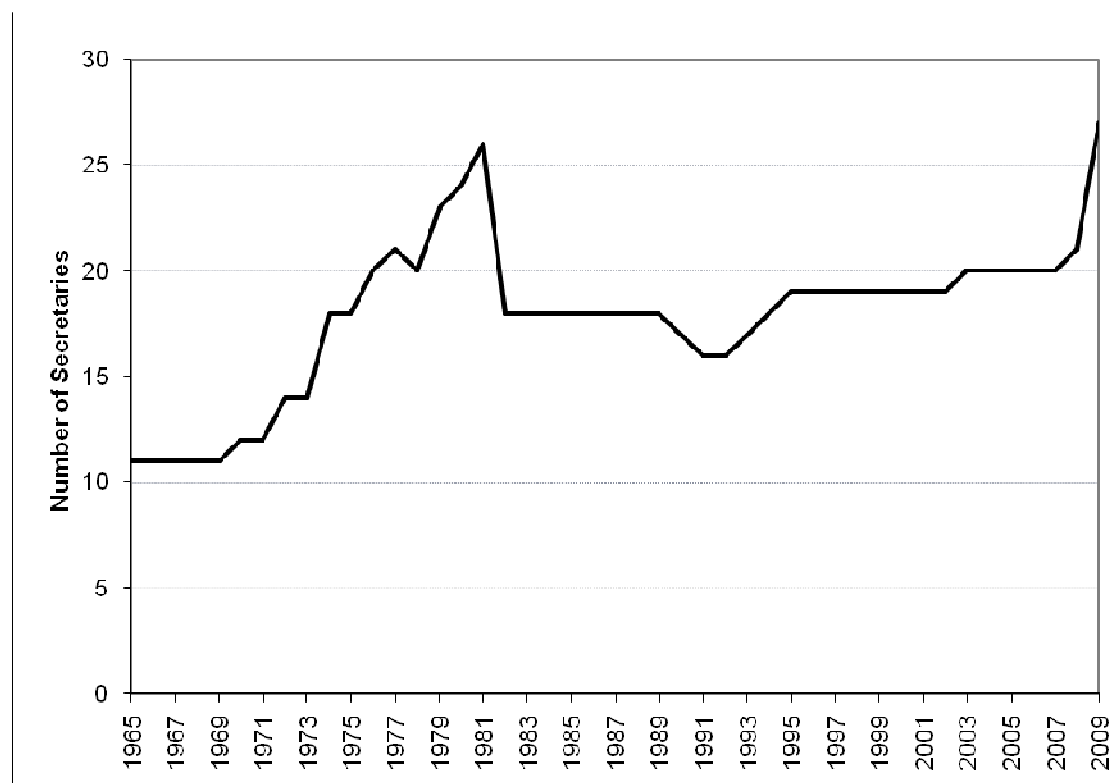
<sup>116</sup> For comparison, the difference is much larger than in the United States. The latest US statistics revealed that the average estimated net worth of all members of the House was US\$ 856.009, while the average net worth of an average American household averaged at US\$ 66.740. This is about 12 times higher (Open Secrets 16.01.2013). 33 out of the 435 members of the House are estimated to belong to the country’s top one percent as regards personal wealth (UST 16.11.2011).



### *Systematic Clientelism*

All presidents distributed clientelist favours. Public sector positions and public resources have been important currencies to gain support and buy off opponents. Yet, as the analysis of cabinet size and compositions, and the prevalence of presidential advisers, assistants and consultants shows, patterns and the intensity of personal favours varied. Figure 5.1 describes the cabinet's growth trend between 1965 and 2009.

FIGURE 5.1: *Size of Cabinet, Philippines (1965-2009)*



Sources: Data from Macmillan's Statesman's Yearbooks (1965-2009).

Cabinet size fluctuated between 11 and 27 cabinet secretaries over the period of 45 years. The highest number of cabinet secretaries, in 1981 and 2009, occurred both at times when the incumbent presidents felt strongly under pressure. On average there were 17 secretaries; internationally this is regarded as reasonable. The pattern suggests that systematic clientelism via cabinet positions has hardly taken place.

Marcos started his presidency with a very low number of cabinet secretaries; he steadily increased to 26 throughout his rule. Initially, Marcos appointed a considerable number of civilian technocrats, whose technical skills were strong, but who were politically weak. By showcasing his cabinet, Marcos was able to gain support from the United States, the International Monetary Fund, and the World Bank. He secured a continuous flow of money to the state coffers, and made sure that his powers were not in danger. Kang (2002: 82) argued, "Marcos appears to have fully intended to ignore the

technocrats that he hired". And indeed, Marcos not only created channels that bypassed the departmental secretaries, but dispensed favours to his cronies which circumvented and overrode almost any decision taken by the technocrats. Yet, he "did not pass state patronage around as incumbent presidents usually did but concentrated it in the hands of his family and friends" (Thompson 1995: 43).

Soon, after the declaration of martial law, Marcos turned his wife Imelda Romualdez Marcos into the second most powerful person in the country. He appointed her Governor of Metro Manila and created a new ministry for her to head, the Ministry of Human Settlements. "Imelda Marcos controlled public and private funds equal to 50% of the total government budget, with little accountability" (Overholt 1986: 1148). Benjamin "Kokoy" Romualdez, Marcos' favourite brother-in-law, was given de facto control of the Bureau of Customs, Bureau of Internal Revenue, and the General Auditing Commission (Thompson 1995: 53). Other cronies were appointed to political assignments of their choosing, among others strategic positions in the military, in civil service, and in state-owned enterprises. Others were provided with lucrative opportunities in the private sector (see Manapat 1991). Disenchanted and frustrated several cabinet members resigned. His last cabinet contained only individuals loyal to him.

The cabinets of Marcos's successors also tended to be the result of 'compromise', yet for a different reason. Under the 1987 Constitution, the president's ability to appoint is constrained, as presidential appointments need approval from a congressional Commission on Appointments.<sup>117</sup>

According to a report of the Philippine Center for Investigative Journalism, CA members often approve nominees in exchange for these officials accommodating the lawmakers' recommendees at their departments. Or, in exchange for these officials eventually turning some department funds into virtual pork barrel for lawmakers (N 29.08.2001).

In response, it is often consensus candidates that are appointed.

Corazon Aquino's cabinet resembled a rainbow cabinet; with individuals who had served under Marcos, individuals who had supported the revolution, and those Aquino felt comfortable with. This factionalism led to intergovernmental conflicts.

Ramos's cabinet was more a military-industrial elite. Businessmen, who had supported his campaign, were given economic appointments (FEER 09.07.1992). The Commission on Appointments failed to confirm many of his appointees until a year after he had taken office. Ramos accepted the denial of some secretaries, e.g. Finance Secretary Ramon del Rosario, yet he did not accept the denial of others, like Transportation and Communications Secretary Jesus Garcia. To govern, Ramos established a legislative-executive-advisory council (LEADC).

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<sup>117</sup> This oversight body consists of the Senate president, as the ex-officio chairman, and 12 members each from the Senate and the House of Representatives. Commission members are selected according to the proportional representation from the political parties and party-lists in each chamber. The chairman does not vote, except in case of a tie.

Estrada had two cabinets: His official cabinet, composed of “known experts, academics, left-leaning and progressive leaders, [and] development advocates” (Rebullida 2006: 202), and his “Midnight Cabinet”, composed of personal friends with whom he met over a couple of drinks and gambling games at night. Estrada appreciated his friends’ advice and recommendations many times over those by his cabinet secretaries.

Arroyo’s approach towards cabinet composition differed between the term when she completed Estrada’s presidency and that of her own from 2004 until 2010. Initially, her stated goal was to foster technocracy to improve the Philippines’ socio-economic situation. She appointed individuals who had been associated with the governments of her predecessors Aquino and Ramos as well as individuals of civilian and military background who had supported her in Estrada’s overthrow. Later, Arroyo increasingly appointed loyalists, if it even was for only a few months until she replaced them with someone else.

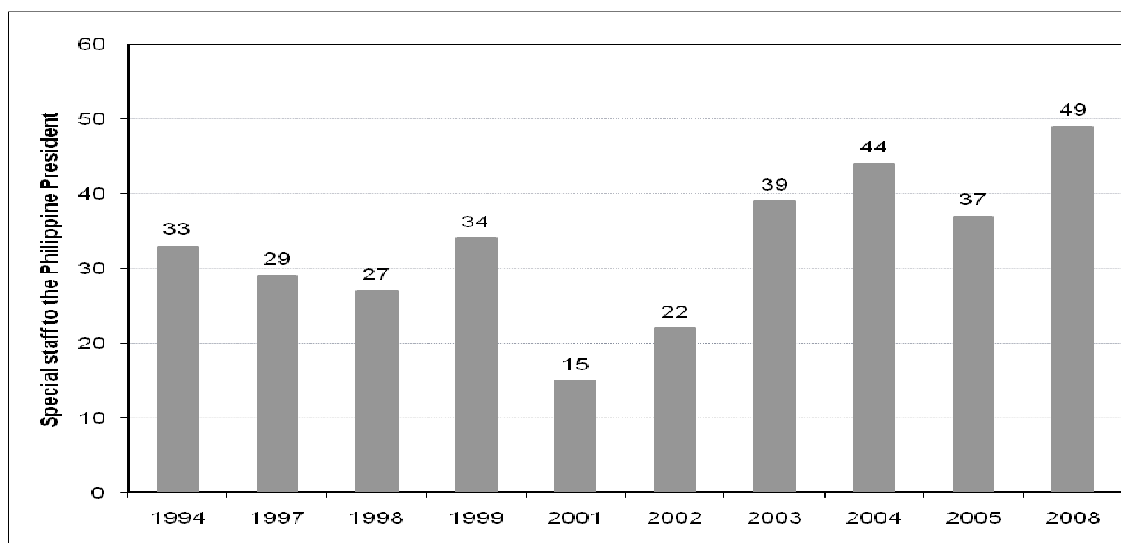
Collectively, in mid-2005, a group of eight cabinet secretaries and two senior revenue officers, the Hyatt 10, resigned. They appealed to Arroyo to voluntarily relinquish the presidency. Their expressed concern was that, with her legitimacy in doubt, Arroyo’s “decision-making would be dictated not by the demands of reform and good governance but mainly by political accommodations to serve the ends of day-to-day political survival”. Competence and professionalism, so they claimed was sacrificed, while juicy positions were doled out (Hyatt 10 2005a, 2005b).

Arroyo reappointed again and again appointees that were bypassed by the Commission on Appointment. The distribution of clientelistic favours via the cabinet remained limited though: Arroyo used other existing and newly created positions in government.

This was not unique to her government however. Appointments of presidential assistants, advisors, consultants, as well as special coordinators who hold title and authority without the requirement of accountability, featured prominently in all presidencies. Until 1982, Marcos had increased “the number of non-cabinet ministers of state from four to nearly 50 in a political move to counterbalance the preponderance of technocrats running the government” (Youngblood 1982: 230). His successors acted similarly.

Department of Budget and Management statistics for the years 1994 until 2008, as depicted in Figure 5.2, indicate an upward trend.

FIGURE 5.2: *Official Number of Presidential Assistants, Advisors and Consultants, Philippines, (1994-2008)*



<sup>a</sup> Actual numbers of special staff to the president are likely to be higher.

Source: Data from the Department of Budget and Management (2009).

Functional necessities cannot explain the appointment of most of the special staff, as their official job assignments do overlap with the tasks already performed by existing government agencies and departments (PCIJ 25.04.2008). This creates redundancy and conflicts of authority, and may also be an avenue for presidential cronies to misuse government office for private purposes.

Aquino III also has been criticised for basing his decisions whom to appoint to his cabinet and major agencies on the principle of “*KKK – kaklase, kaibigan at kabarilan*” [classmates, friends, and shooting buddies]. Yet, it is acknowledged that, he also considers qualifications, competences and capabilities, and respects legal boundaries.

#### *Particularistic Use of State Resources*

The Philippines has been a paradigmatic corrupt state, where the distinction between the private and the public realms is blurred. Particularistic behaviour like cancer cells “metastasized to all parts of the government and surrounding society” (Coronel 1998: 11). Top-down predation as well as bottom-up rent-seeking occurs.

Many Filipinos, referring to positively connoted traits and values, like debt of gratitude [*utang na loob*], getting along [*pakikisima*], and kinship ties [*pamilya*], accept the exchange of favours as common practise. Not only Higgins (1957: 163) concluded that, “one sometimes feels that in the Philippines the sin is not in an official’s diverting public funds to his own bank account but in getting caught”. Politicians and government officials trade the release of and priority in the allocation of funds, influential government posts, key positions in civil service, military and politics, government

contracts, legislation, preferential trade and investment opportunities, and bailouts, in exchange of bribes, financial and personal support, and votes.

Ferdinand and Imelda Marcos, for example, became prominent for enriching themselves and their cronies. Marcos was known as 'Mister Ten Percent', receiving a cut of every business transaction, and requiring his departments to save 10% of their budgets annually to be re-designated as funds to be used for 'special projects'.<sup>118</sup>

At least since 1922, pork barrel funds, which are discretionary, have stood in the focus of presidential and congressional interests (Vidallon 1966). The president receives P 60 billion annually and can transfer any 'unused' (read: unreleased) budgetary items to 'savings' that become discretionary funds at his/her disposal. Also, senators and congressmen are entitled to congressional insertions and annual lump-sum allocations from the Priority Development Assistance Funds (PDAF), formerly known as Initiative Funds and Countrywide Development Funds, which they can use to conduct unspecified development projects in their home constituencies (De Dios 1999: 144-146).<sup>119</sup>

The release of funds however depends upon the president's consent. Presidents are inclined to use PDAFs as a bait to gain support, a treat for advocates and followers, and a weapon against non-partisans and contestants. Under Arroyo, opposition politicians reported that they had to wait particularly long for release, and at times did not receive any allocation at all. Politicians maintain that they do not have any choice, as their constituents expect and explicitly ask for financial contributions to public and private matters, as well as their personal support in obtaining a job or other matters. A politician interviewed put it in the following terms,

The way it happens here, if you personally do not deliver the basic services or the basic needs of the people, you will not be able to win the next election, no matter how good a legislator you may be.

"Political power is converted into a power to create projects, not legislation" (Interview: Other Government Official). As PDAF projects are officially inaugurated and prominently attributed to the local representative --stickers and banners can be found in most Philippine cities-- but often fail to be really necessary and finished, and also lack in maintenance, one may believe that legislators use the funds to strengthen their patronage ties and embezzle a portion for private needs (PCIJ 06.-07.09.2004). As a civil society representative interviewed put it: "The majority of politicians call it a SOP [standard operating procedure], that a percentage of the total amount is given to them".

Relatedly, Quimpo (2009: 335) noted that

Over the past decade, and especially over the past few years, political corruption, fraud and violence in the Philippines have reached such alarming levels that many Filipinos have grown despondent, even cynical, about their country's political system.

<sup>118</sup> Transparency International estimated, that Marcos embezzled between US\$ 5 to 10 billion during his twenty years in power. For illustrations of Marcos's wealth see Manapat (1991). While a court suit was filed, neither Ferdinand nor Imelda Marcos were sanctioned.

<sup>119</sup> In 1995, each senator was entitled to about P 18 million, each congressman to P 12.5 million. This amount increased to P 120 million for senators and P 60 million for congressmen in PDAF in 2008. In pre-election years funds tend to be higher than in ordinary years.

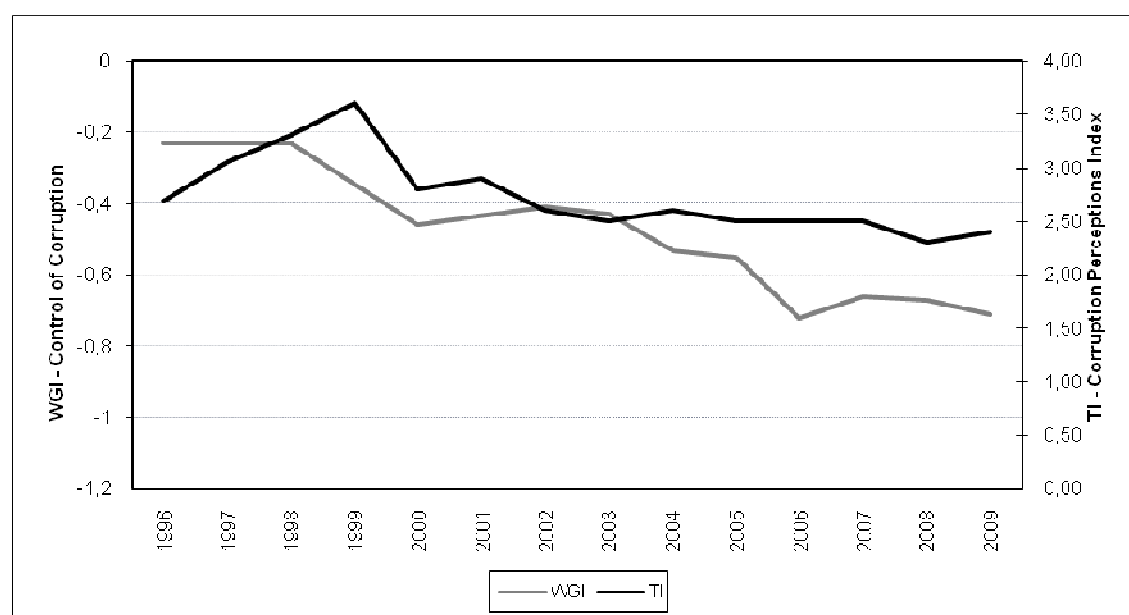
This observation is in line with public opinion surveys, in which Arroyo ranked the most corrupt president in Philippine history (GMAN 11.12.2007), and the author's insights gained during field research in 2009. So did a civil service representative comment on Gloria Arroyo's anti-corruption policies:

Generally now, there is really no overall commitment to fight corruption. The President just recently issued an Administrative Order in joining all agencies to engage in a moral recovery programme. I do not know what that is. Fighting corruption by memo? You do not fight corruption that way...

and a former member of Arroyo's private sector funded Governance Advisory Council (GAC), which was established to promote transparency and accountability in government, interviewed, stressed that actually the GAC was "not on her radar screen. ... If you get a deaf ear, you cannot really do very much".

The worsening trend reflects in Transparency International's Corruption Perceptions Index and the World Bank's Governance Indicators, as depicted in Figure 5.3.

FIGURE 5.3: *Control of Corruption and Corruption Perception Indices, Philippines (1996-2009)*



<sup>a</sup> The 'control of corruption' indicator ranges from -2.5 to +2.5, with higher scores denoting "better" outcome. The 'corruption perceptions index' ranges from 0 to 10, with the value 10 denoting the lowest level of perception of corruption. Year-to year comparisons have to be handled with caution, as changes in score can result from a changed perception, but also from a change in the sample or methodology.

Sources: Author's illustration based on data from the World Bank and Transparency International.

Transparency International and the World Bank has placed the Philippines consistently among the world's worst third of countries since 1996. Since 2000, the overall trend has been negative, with slight stabilisation only between 2007 and 2009.

### *Conclusion: Neopatrimonial Environment of Reforms*

Neopatrimonialism has long characterised the Philippine state. For decades, all three of neopatrimonialism's dimensions have featured consistently. The broad outlines showed a high degree of stability; changes occurred in details only. There is strong evidence for path dependence. Since independence, power has been heavily concentrated in a small economic elite. The country's elite, whose personal business interests are strong, share political office at both national and sub-national level amongst each other. Systematic clientelism has been a constitutive element of the political system. Yet, the high degree of political particularism has led to negotiations between the president and individuals as opposed to political parties whose role is negligible. Appointments in excess of legal regulations occurred regularly; within the last decade they have been particularly apparent. Corruption in the Philippines has been pervasive. Since the 2000s, the perception is that corruption's extent has increased. The analysis of the country's neopatrimonial profile suggests that the preconditions for effective taxation and tax reforms have been poor. The domination of politics by the economic elite is likely to be hostile to tax reforms. The strong incentives for particularism also make it difficult to garner support for reforms that have a broad-based target beneficiary base. Sweeping reforms seem highly unlikely; smaller reforms a challenge.

### **5.2.2 Public Administration Concept**

The Philippines was colonised twice: by the Spanish (1565 to 1898) and the United States (1898 to 1946). The Spanish did not establish a professional public administration: They relied on few colonial administrators at the centre and friars and missionaries in the provinces; native Filipinos, usually from the locally dominant families, participated only at the municipal and village level. This way the native feudal culture was fostered. In Spain, nepotism and bribery, later on the sale of public office to the highest bidder, influenced who was transferred to the colony. This and insufficient oversight tainted the quality of the colonial administration. Rather than a public trust, public office was seen as a grant from the Spanish king, a symbol of status, and a personal investment to be recovered quickly (Endriga 1985: 133f).

The Americans differed in their approach. After President McKinley had solemnly declared in 1899 that "The Philippines are ours, not to exploit, but to develop, to civilize, to educate, to train in the science of self-government", in 1900, the Taft Commission introduced a "modified copy of the American civil service as it existed at the turn of the century" to their colony (De La Torre 1986: 49).<sup>120</sup> Almost two decades, Americans filled the higher ranks in the 9,000 men strong colonial government. As the colonisers doubted the natives' qualifications for self-government, Filipinos were employed only at the lower ranks. Only by 1920, yet without prior systematic administrative and technical training of Filipinos, the proportions were markedly

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<sup>120</sup> Act No. 5 "An Act for the Establishment and Maintenance of an Efficient and Honest Civil Service System in the Philippine Islands".

overturned. "In 1903, the classified civil service recorded 51% Americans and 49% Filipinos, by 1920 the list showed 4% Americans and 96% Filipinos" (De La Torre 1986: 51). Employment with the civil service had been popular with Filipinos because of the prestige it carried and benefits it provided. Yet, it did not attract the best and brightest. The landed elites consolidated their control over the state. "...[P]rovincial power holders came to enjoy a great deal of influence over all levels of governance" (Hutchcroft 2000: 278). Nevertheless, the American colonial power retained direct control of the civil service until 1935.

The Americans introduced a highly centralised career civil service system, with entrance examinations, security of tenure, monthly salaries, leave provisions, and special attention on qualifications and merit (Stene 1956; Corpuz 1957). Government officials and employees were generally barred from engaging in politics and private business. The idea of an impersonal civil service however conflicted with Filipino values and experience. Soon after Filipinos were given control, while formal commitments to a legal-rational civil service remained high, standards deteriorated.

While formally based on merit, the Philippine civil service did not function this way (Bell et al. 1950: 27). The *compadre* system and *utang na loob* considerations influenced official decision-making. External interference occurred. Inadequate salaries further undermined good intentions. Taking its toll on the efficiency of the civil service, a comprehensive set of reforms and anti-graft measures were introduced.<sup>121</sup>

Yet, as Corpuz (1960: 304), National Scientist of the Philippines, observed,

it is impossible to look anywhere in the political system without seeing the family influence at work and established in some political custom or practise. Kinship ties and loyalties have proved resistant to political "reforms" and to civil service rules on recruitment into the bureaucracy, and nepotism is a notorious but ethically condoned practice.<sup>122</sup>

Since, every new government has vowed to improve the administration's quality and performance. Reform programmes were set up, reorganizations initiated and increasingly stricter and more comprehensive laws and regulations enacted. Hence, "... one can safely say that legally, the Philippine civil service system is probably among the best in the world and the Filipino civil servant among the best qualified, as well as the most protected" (Briones 2005: 286). Reform outcomes however fell short of expectations. Alex Brillantes, Professor of Public Administration at the University of the Philippines, put it in the following terms: "things have changed, but things have stayed the same" (Robles 2008: 285), strongly arguing for path dependence. His colleague, Ledivina Cariño went even further stating that "Civil service reforms are getting 'betterer' and 'betterer', actual practises are getting 'worsen' and 'worsen'" (Briones 2005: 293).

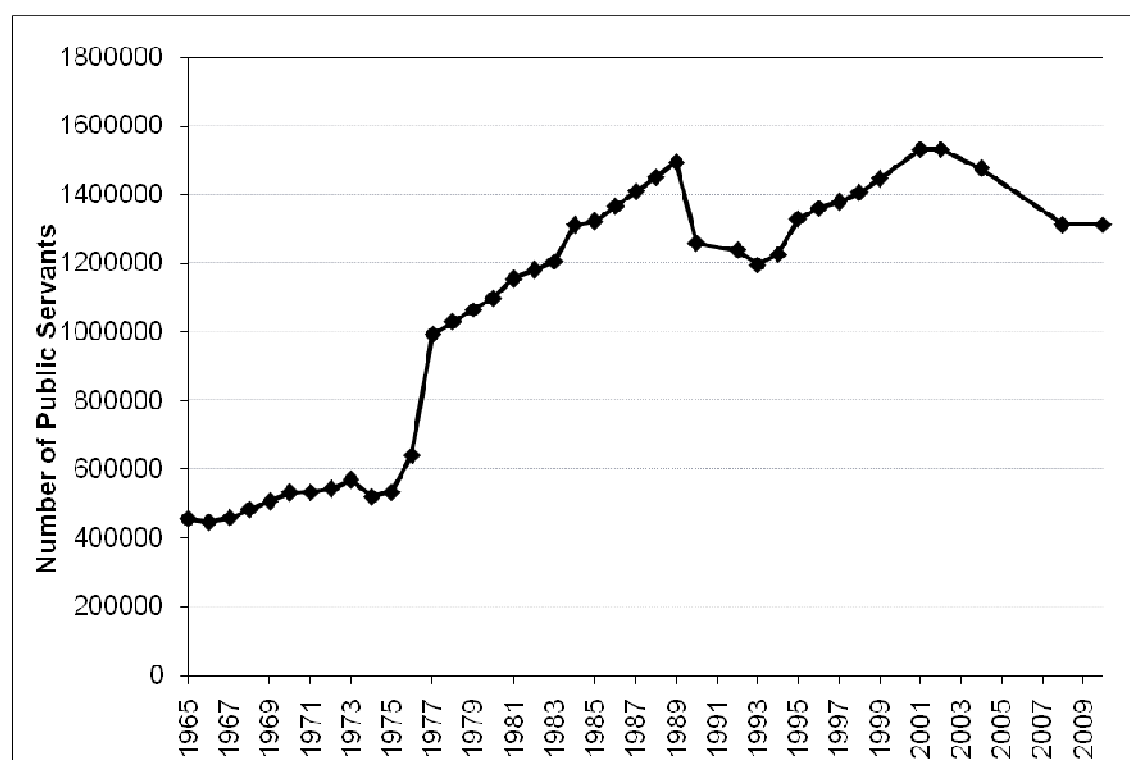
<sup>121</sup> Among others a Wage and Position Classification Office, Government Advisory Board on In-Service Training, a Presidential Complaints and Action Commission were established, and a new Civil Service Law, Republic Act No. 2260, enacted. The Bureau of Civil Service was transformed to a Civil Service Commission and given departmental status.

<sup>122</sup> In 1964, more than 80% of national government employees had entered the civil service as temporary appointees without competitive examination (Wurfel 1988: 79f).



Under the Integrated Reorganization Plan, between 1972 and 1975, with his executive powers Marcos removed between 3.500 and 5.000 civil servants; including the whole Board of Examiners and all Civil Service Commissioners.<sup>123</sup> Marcos explained that these removals were based on performance audits and intended to “cut off the infected party off the infected parts of society from active public life, before they endanger the entire body politic” (FEER 07.10.1972, 03.10.1975). As Figure 5.4 points out, soon after, Marcos significantly expanded the size of the public administration, which suggests that he purged mainly “notoriously undesirables”.

FIGURE 5.4: *Size of the Public Administration, Philippines (1965-2010)*



<sup>a</sup> Numbers include officials and employees deployed at central and local governments, as well as at government-owned and controlled companies (GOCCs).

<sup>b</sup> Non-career officials are not included. Anecdotal evidence suggests that their number increased when the number of career civil servants decreased.

Sources: Data for 1965-1989 from Endriga (2001: 246), for 1990-1999 from Brillantes (2006), additionally from various Civil Service Commission Annual Reports.

Until 1986, the absolute number of civil servants almost tripled. The civil servant to population ratio, decreased from 1: 69 in 1965 to 1: 41 in 1986 (Author's calculation).

Corazon Aquino aimed at civil service's “de-Marcosification”. She instructed general reorganisation and purges almost simultaneously. A Civil Service Commission (CSC)

<sup>123</sup> The official goals were to decentralise bureaucracy, downsize the civil service, and strengthen the merit system by standardization of organizations and common civil service operations.

study estimated, that about 27.500 employees were affected during the first two years of her presidency (Cariño 1990: 12). Soon after, the number of employees expanded again. The Senate Economic Planning Office (2005: 2) noted that overall from 1960 to 1997 the Philippine bureaucracy grew faster than its population -- 282% against 160%. Only since 2002, the number of civil servants has been decreasing. By 2010, the civil servant to population ratio reached 1: 69.<sup>124</sup> The Philippines' deteriorating government budget balance, caused partly by insufficient domestic revenues, had forced the government to rationalise its expenditure structures.

An increase of government bodies accompanied the increase in civil servants. Duplication and overlap of accountabilities, functions, and jurisdictions across offices at all government levels were the result. This created confusion and a wide-range of inefficiencies. An interviewee explained:

In the whole government there may be two or more people doing the same thing, but they do not know about each other. You find out that different parts of government are doing different part of things, which nobody knows about, whereas they should really know what each and everyone is doing, so that they do not duplicate and just feed into each other.

One might gain the impression that agencies were established to create positions and parallel channels for interest negotiation and decision-making.

Elite influence on the Philippine civil service has been strong. There is a high degree of politicization. The 1987 Constitution and the Administrative Code, generously interpreted, allow the president to personally appoint staff for about 3.500 third-level positions and 6.500 second-level positions. The third level covers managing and supervising positions in the career executive service, comprising the positions of undersecretary, assistant secretary, bureau director, assistant bureau director, regional director, assistant regional director, and the chief of department service. The second level includes professionals, carrying out technical and scientific work, which require at least four years of collegiate studies, up to the level of division chiefs.<sup>125</sup> Already by law, the penetration of politics in the civil service is deep.

Yet, Karina Constantino-David, former Chairperson of the Civil Service Commission<sup>126</sup> (2001-2008), maintained that President Arroyo (2001-2010) made numerous appointments in excess. This statement is backed up by various government documents. For example, while the Administrative Code restricts the number of undersecretaries and assistant secretaries at departments to three each, the Department of Finance between 2003 and 2010 each year was staffed with five to six undersecretaries and up to five assistant secretaries (DOF ARs 2003-2010).

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<sup>124</sup> Civil servants represent 2% of the total population, yet 20% of the employed. Thirty percent of the national budget is reserved for personnel expenditures (Senate Economic Planning Office 2005: 1).

<sup>125</sup> The first level includes clerical, trades, crafts, and custodial service positions for which less than four years of collegiate studies are required. These career positions are permanent with security of tenure, albeit formally based on performance since 1992 (Civil Service Decree, Presidential Decree 807).

<sup>126</sup> The CSC is the central personnel agency of government. It holds quasi-legislative and quasi-judicial powers to formulate and administer civil service rules and sanction those who violate them (Executive Order No. 292; 1987 Administrative Code).

Moreover, Arroyo allegedly appointed thousands who were not civil service eligible. In a public speech, David stated, "... of the more than 3.000 managers in government, career managers, less than half of them are qualified. ... More than 50% of the present Career Executive Officers appointed by the President to positions are not eligible" despite more than 4.000 eligible civil servants in government waiting to be promoted (Constantino-David 2008: 4f). Interviewed by the author, she added:

Arroyo appointed people with no civil service eligibility, even worse people that could not pass the test. ... They control the entire bureaucracy. Of the 11.000 about 5.000 are career positions, occupied by non-career people. ... She went beyond that with what is called desire letters, for positions, which are not even her appointees, or positions in GFIs [government financial institutions] and GOCCs [government owned and controlled corporations]. She would say: 'I want this person appointed'. So these 11.000 are actually much more. ... In effect, the only positions, she does not control are local government units.<sup>127</sup> It is major because this President has expanded her appointing powers more than any other president has, and has taken out in addition to that career civil servants completely eligible with security of tenure and replaced them. ... When you let politics govern how you act, then there is no governance involved, it is horse-trading every place.

Legally, the president holds the power to maintain these appointments, as the CSC holds an advisory function only.

Many Filipinos regard having a MBA, which here does not stand for a Master of Business Administration but for having a backer [*May Backer Ako*], as an important factor to gain permanent employment with the civil service. It is thus common to request political support. Legislators write endorsement letters for various reasons: the applicant may be a relative, a good friend, has done the legislator a special favour, comes from the same school, or even only from the same province. These letters, sometimes in thick envelopes, are then passed to the targeted agency, bureau or department. Some letters are little more than suggestions, others are actively followed up by the sponsor [*padrino*]. Inquiries are said to range from simple questions to active intimidation. In exchange, legislators allegedly expect loyalty and contributions to campaign coffers. According to civil servants interviewed, they do not answer all requests favourably. They seek a balance between the agency's priorities and politico-bureaucratic demands.

Comparable mechanisms come into play during civil servants' transfers and promotions. Filipinos' reluctance to openly criticise and confront each other encourages this procedure, as performance management instruments provide hardly any useful information. There is evidence, that most civil servants, regardless of their real performance, receive the highest grades from both their peers and superiors. The majority of Filipinos are inclined to take things personally, thus often "there is no separation between an objective task and emotional involvement" (Ramos-Shahani 1990: 3). As a career senior civil servant interviewed criticised:

<sup>127</sup> Arroyo has left appointing power at the local level to the local executives. Anecdotal evidence suggests that in most regions the local civil service is heavily politicised, as such as many employees are dismissed, transferred, and rotated following local elections, while new individuals enter.

The culture now is that the superior is too ashamed, too embarrassed to say that you are not performing, you better improve. It is a "No, No", even if it is obviously seen that the staff is not performing. Our performance assessment system is more of a political public relations tool, more than anything else. ... government provides productivity incentive bonus for the performing set, but in the department, it is standard, everybody gets.

That everyone officially is an achiever provides additional leeway for the neglect of the merit principle. Moreover, it inhibits the development of a culture of excellence: It encourages civil servants to carry out instructions without questioning and do only what is expected. Not goals are followed, but rules and procedures.

Civil servants themselves tend to become patrons. Allegedly, many perceive the provision of public service not as a professional duty, but rather an extension of personal favour. *Utang-na-loob* seems to be as accepted as the use of entrusted funds and powers to further personal ends. Notwithstanding, many civil servants, often simultaneously, express a critical attitude towards patrimonial expressions in government. Contemplating about her personal experience a civil servant interviewed elucidated:

We really are fond of kickbacks. And then we even praise easy money getters. My brothers and sisters tell me, "Oi, the [Department] will not build a monument for you." ... It is like if you're honest in government you're perceived as crazy.

Bautista (1993: 168) explained this by Filipino cultural values and norms. He claimed, that going against the culture of patronage, "may bring the violator the sanction of ostracism from persons, family, and community". In the same vein, it is argued that the Filipino does not have a real-sense for the nation. Several interviewees shared the belief, that:

Filipinos do not have an idea what it means to be a Filipino. For us, nationhood is being against somebody. A Filipino does not have a sense of mission for the country, ideals, or what you want to build as a country.

It is just your family and yourself.

The Filipino definition of family in this regard extends far beyond the nucleolus family, and tends to include the agency one works for.

Another often suggested explanation is the remuneration of civil servants, which is criticised to be much lower than salaries and benefits in the private sector. This however, seems not to hold true for first and partly second level officials. A CSC study came to the conclusion that salaries at the first level were 20% above salaries of comparable positions in medium-sized private sector firms and other competing markets, while at second level being 40% lower, and at third level almost 75% lower (Monsod 2009: 7). These discrepancies are said to have caused highly qualified Filipinos to enter the private sector or go abroad, rather than apply for civil service.

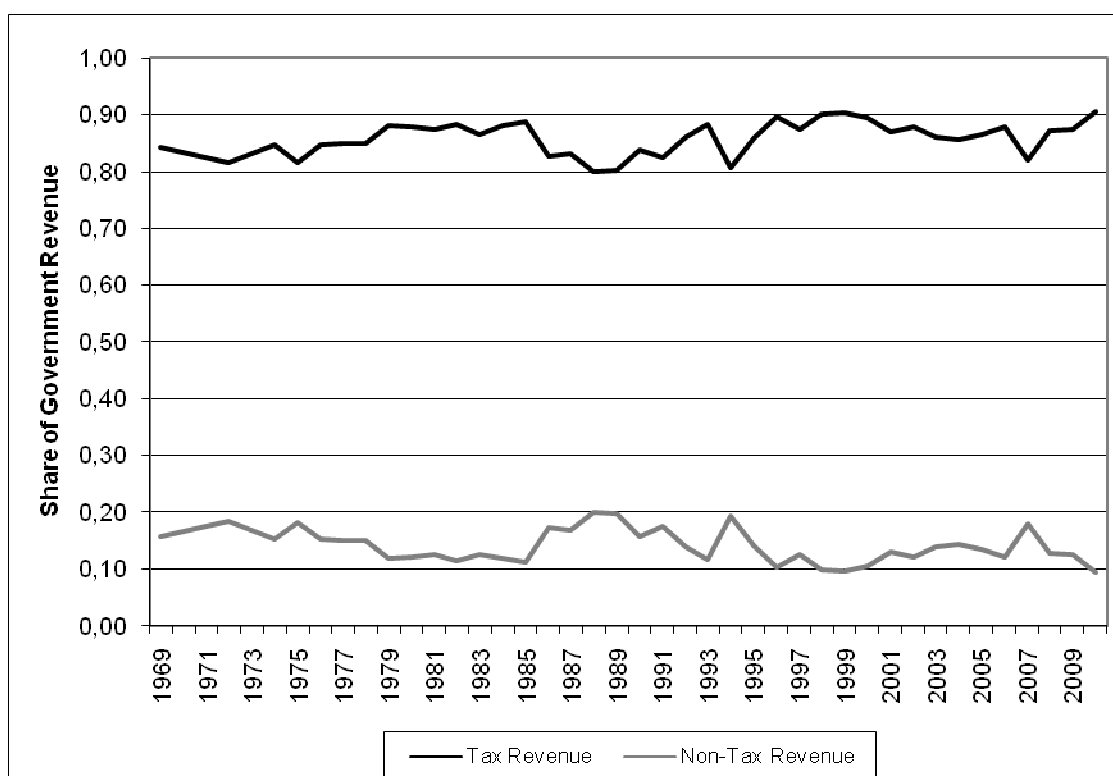
The Philippines' public administration system in its laws and regulations in many aspects follows international good practise standards. Patterned after the American model and long-term subject to reforms, on paper it is strictly rules based and follows the merit principle. In implementation, practises, however, often fall short of the prescribed standards. Nepotism rules strong in the Philippine civil service. The civil

service is heavily politicised. On the national level it is the president who, by law already, has extensive appointing powers. In recent years the president further made numerous appointments in excess, appointing also individuals not holding civil service eligibility. At local level the local executives exert strong influence in the distribution of positions. In exchange for appointment, loyalty to the sponsor is expected. In combination with largely ineffective performance assessments these practises have led to significant inadequacies and inefficiencies in public administration. We can presume that these also affect the tax administration. As weaknesses are deeply entrenched and numerous reform efforts in the past already did not get much further than improving the legal framework, the prospects for meaningful change appear dim. Reforms seem possible, but very difficult to achieve.

### 5.2.3 Socio-Economic Development

The Philippines has never been a particularly resource-rich country. As Figure 5.5 points out, ever since the country has depended on raising tax revenues. Primary commodity export rents and official development aid have never been high enough to replace taxation as a means to finance the state.<sup>128</sup>

FIGURE 5.5: *Composition of Government Revenue, Philippines (1969-2010)*



<sup>a</sup> Available data are weak, hence graphs are to be interpreted as indicating development trends.

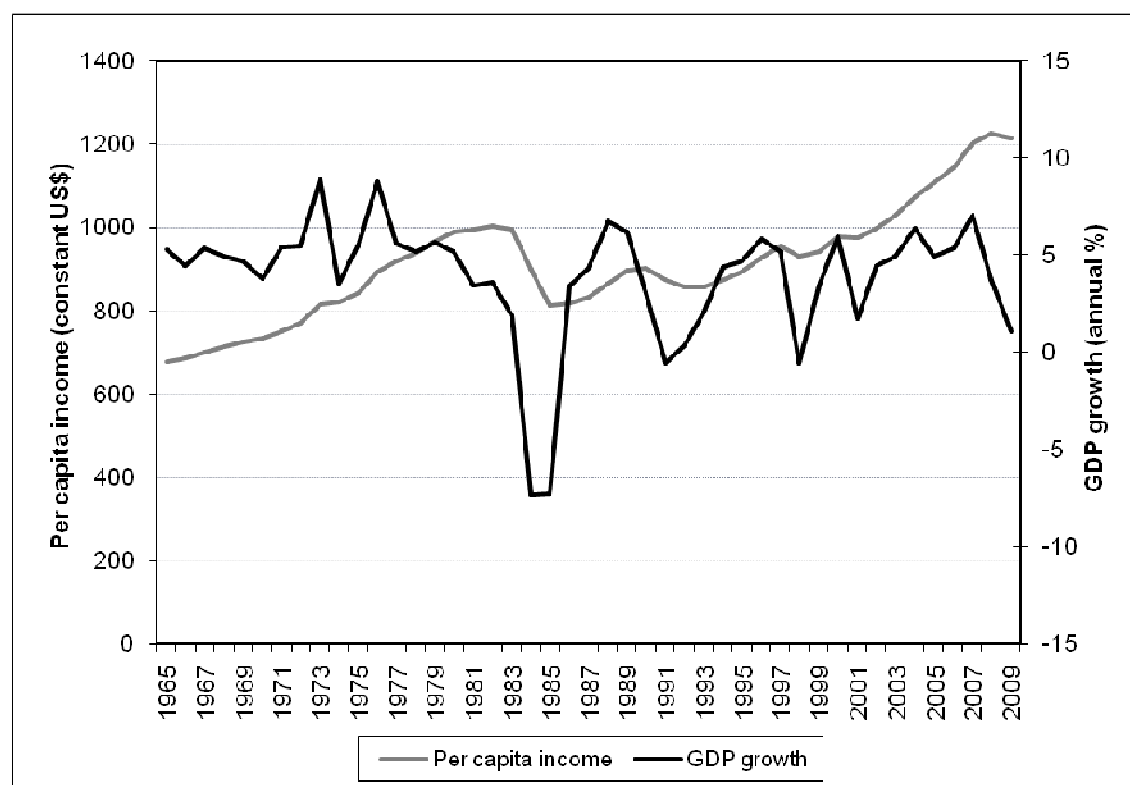
<sup>128</sup> According to World Bank data, they reached only up to 3% of GNI in the late 1980s early 1990s.

<sup>b</sup> Philippine official statistics have not differentiated types of non-tax revenues consistently. Hence, separate figures for grants are not available for this case study.

*Source:* Data for 1969-1974 from Cheetham/Hawkins (1976: 388, 392, 548), for 1975-1999 from the Philippine Bureau of the Treasury and the Department of Finance as cited in Paderanga Jr. (2004: 304f), and for 2000-2010 from the Philippine Bureau of the Treasury (2011).

Right after independence, the Philippines was one of the most promising candidates for socio-economic development. The country had one of the highest economic growth rates and per capita incomes in East Asia, below only Japan, Malaya, Hong Kong and Singapore. Yet, the Philippines failed to capitalise on its favourable initial conditions (see Canlas et al. 2009). As Figure 5.6 suggests, the country hardly profited from the Asian boom of the late 1970s and 1980s. Neither was it able to show significant development in the following decades. The country's reputation deteriorated; soon the world called it "the sick man of Asia" or the "East Asian Exception". The Philippines has been an Asian exception, both in the negatively connoted sense, and as the 1997/98 Asian financial crisis, within its course the Philippines was less affected than other Asian economies, also in the positively connoted sense.<sup>129</sup>

FIGURE 5.6: *Per Capita Income and Annual GDP Growth, Philippines (1965-2010)*



*Source:* Data from the World Bank.

<sup>129</sup> Partly however, this positive outcome was the result of the Philippine economy being more detached from the international economy than countries which were more affected.

The economic growth rates show an erratic pattern. Periods of considerable decline follow boom phases. Growth rates were highest in the 1970s, peaking twice at almost 9% annual growth in 1973 and 1976. Since 1977, it declined steadily and plunged in 1983. The slump was triggered by Aquino's assassination, but also a result of previous years' inefficient economic policies. Between 1965 and 2010, overall the country's growth rate was lower than its neighbours'. Within the last four decades Philippine per capita income only doubled. In 2000, per capita income was essentially the same as in 1980. In the 2000s it grew significantly. However, it may have been over-borrowing and rising remittances from overseas Filipinos (OFWs) which triggered this growth.<sup>130</sup> If this were the case, there are doubts about long-term sustainability. By 2009, the World Bank classified the Philippines a lower middle-income country.

Comparing the development of economic growth rates with the rotation of presidents in democratic Philippines over time a pattern can be recognised: The economy tends to grow at the beginning of a presidential term, declines sometime in the middle, shows its lowest point at the end of the presidency, before starting to recover again during the initial years of the subsequent presidency. Only the contraction in 1997 has clearly been caused more by an external factor, the Asian Crisis, than by domestic developments.

Therefore, it is just to deduce that Philippine socio-economic problems, at least partly, can be attributed to government's economic mismanagement. In this regard, Arroyo's presidency offers a particularly interesting story: During the first years of her government, the economy on average grew faster than under her predecessors Aquino, Ramos and Estrada. Economic observers expected economic progress, yet the situation changed the more Arroyo felt her government was under pressure. The list of macroeconomic problems, which had been long already, became even longer.

The Philippines long-term development goals have been in danger. Most serious arguably are its annual fiscal deficits and its accumulated debt (see De Dios et al. 2004; Sicat 2007b). According to World Bank data, during the last two decades cash deficits averaged at minus 2.5% of GDP. Central government debt meanwhile increased from 50% of GDP in 1990 to almost 80% in 2004.<sup>131</sup> Since the mid-2000s, 40% of the annual national budget has been reserved for debt interest and principal amortization payments. Adding the 30% for public sector salaries, the space left for variable spending is small.

In light of continued rapid population growth, government is left with only two choices: increasing domestic revenues or cutting back on expenditures. Non-governmental organisations alleged that President Arroyo resorted to the latter, while government

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<sup>130</sup> Nearly 10% of the Philippine population and about 25% of the total labour force are living and working abroad. Remittances have grown significantly throughout the years. Within the last decade alone, they more than tripled from US\$ 6.961 million in 2000 to US\$ 21.423 million in 2010, equivalent to 11% of the country's GDP. As these are official figures, it is likely that actual amounts are higher. For comparison, the official GDP share of remittances is eleven times higher than in Indonesia. The income of OFWs earned abroad is tax-exempt in the Philippines (POEA 2010; World Bank 2011a).

<sup>131</sup> The World Bank does not provide data on Philippine central government debt since 2005. For other countries this data is available until 2009. With regard to the Philippines' politico-economic situation it is likely that debt rather climbed than declined during these years.

maintained that it made significant achievements. The official budget and spending statistics indicate that spending on infrastructure, health and education has declined.<sup>132</sup>

As Chapter 5.2.1 indicated, in the Philippines wealth and opportunities are not equally distributed. According to the Forbes magazine (07.07.2010), the 40 richest Filipinos are collectively worth US\$ 23 billion, equivalent to approximately 12% of the annual GDP. Claessen et al. (2000: 108), based on data from 1996, argued that the Philippines' Top 15 families control more than 45% of the GDP.<sup>133</sup> The country's human development index (HDI) has improved from 0.52 in 1980 to 0.64 in 2010, while the Gini ratio has been fairly persistent at 0.44 (UNDP).<sup>134</sup> In the last decade, poverty decreased in relative terms, yet increased in absolute terms. The Philippine government subscribes to redistributive measures and policies, yet seems to do little to address these issues.

Official labour participation in the Philippines has been high. Less than 10% of the country's 61 million workforce is unemployed. Yet, of the labour force, according to the National Statistical Coordination Board about 25% are working abroad, 19% are underemployed, and about 60-70% are either non-regular workers or active in the informal sector. The NSCB (2007: 3) further estimated that, the informal sector, with an enterprise share of 44%, accounts for more than 60% of GDP.

The analysis of the Philippines' socio-economic development emphasises the country's need to collect domestic tax revenues but also points out significant difficulties in doing so. While independent Philippines started as a promising case for economic development, the country's situation for decades has been deteriorating. The Philippines' list of chronic macroeconomic problems is long and problems are increasingly pressing. This should give sufficient grounds and motivation for comprehensive tax reforms. Implementation however appears difficult: The Philippines' economic elite dominates the country's politics and holds strong influence over the country's bureaucracy. This elite has more to lose than to win from sweeping reforms, hence it is unlikely there would be much support. The large size of hard-to-tax groups further is an impeding factor. Overall, the economic outlook for taxation is ambivalent.

## 5.3 Administrative Conditions for Reform

### 5.3.1 Evolution of the Tax Administration

Early forms of taxation can be traced back to pre-Hispanic times. Then, *datus* obliged their personal following, comprising 30 to 100 households, to make regular

<sup>132</sup> According to the World Bank (2011: 6) the Philippines' public spending gap as compared to its neighbouring countries is 2.5% of GDP in basic education, 0.7% of GDP in health, and 4% of GDP in infrastructure. The impact is serious. For instance, according to data the author obtained from the Department of Education, despite only 10 school years until high school graduation, public schools operate in double shifts, class size has increased to an average of more than 50 students, and three pupils share one book. In Indonesia, class size averaged at 40 students.

<sup>133</sup> For estimates of family income distribution from 1985-2009 see Africa (2011).

<sup>134</sup> For an explanation of the HDI and the Gini coefficient, see footnote 49.



contributions [*buis*].<sup>135</sup> In exchange for shares in local produce, gold tributes and labour, the *datus* as the 'men of prowess' and personal masters promised their following protection, security, and assistance (Abinales/Amoroso 2005: 27-40).

The Spanish introduced nationwide collections. The King of Spain, in recognition for the Philippine Islands' vassalage, expected tributes in cash and kind. Church-related organisations expected compensation for their activities (Cushner 1971: 102f). The colonial power thus divided villages into crown *encomiendas* and private *encomiendas*.<sup>136</sup> The latter were granted to the church, the *conquistadors*, and other private individuals and entities. Forms of tribute collection differed: Private *encomiendas* hired soldiers; crown *encomiendas* employed professional collectors, the *cobrador de tributes*. Local officials acted as assistants. In compensation the collectors received a commission on what they collected (Corpuz 1997: 33).

By 1700, administrative provinces replaced the *economiendas*. "The provincial governor [*alcalde*] acted as the tax superintendent, the municipal mayor [*gobernadorcillo*] as the tax supervisor and the village chieftain [*cabeza de barangay*] as the barangay tax collector" (Calaguio et al. 1985: 3). In compensation the *alcalde* and the *gobernadorcillo* were entitled each to 1%, and the *cabeza de barangay* to 3% of tributes collected (ibid: 5).

Around 1878, an urban property tax, an industrial tax, and a residence tax [*cédula personales*] were introduced to replace the tribute and augment revenue collections. Citizens paid the *cédula* by annual purchase of vital identity documents. Their racial and civil status determined the price (Corpuz 1997: 190f). As by tradition all land belonged to the king, there were no taxes on land. This benefited the land-owning class.

While taxation was introduced for the benefit of the natives, actually only a negligible portion of revenues was spent for public purposes. Often, revenues collected not even made it to the colonial treasury, but only to "the pockets of indolent civil officials and grasping clergy" (Agoncillo/Guerrero 1977: 86; cf. Abinales/Amoroso 2005: 55). The temporary auctioning of tax collection rights for three-year periods to the highest private bidders worsened the situation. Collectors were inclined to recover the costs they had invested at the shortest possible time and create as much personal gain in the remaining time (Manapat 1991: 74-76).

The American approach differed. They initially retained the urban property and industrial taxes, but replaced the *cédula* by a small fee for the issuance of personal identification documents, and introduced a war tax based on wealth and property. The chief royal accountant, American provincial functionaries and Filipino town officials collected the taxes. Meanwhile, in 1904, the American Philippine Commission passed the Philippines' first Internal Revenue Law. Modelled after the United States' internal revenue system, it simplified the Spanish system, centralised taxation, and established the Bureau of Internal Revenue (BIR).

<sup>135</sup> The term *buis* resembles the present Tagalog word for taxes, which is *buwis*.

<sup>136</sup> *Encomienda* was an administrative unit for the purpose of exacting tribute from the natives. Explicitly, it was not a land grant.

The BIR was assigned to the Department of Finance. From 1904 until 1918, four Americans, appointed by the governor general with approval of the Philippine Commission and the U.S. President, held the BIR's highest post as the collector of internal revenue. The Collector was supported by "one deputy collector, one chief clerk, one law clerk, and one chief for each of the following divisions: stamp and property, assessment and returns, and liquidations" (Kang 1965: 189). The BIR's first 69 employees also were largely Americans.

Perpetuated personnel shortages, however, increasingly forced the American colonial power to hire Filipinos. By 1915, they appointed the first Filipino deputy collector. Americans withdrew following the full implementation of the Filipinization policy. The first Filipino collector was appointed in 1918, when the workforce had grown to 500.

The early BIR had been highly centralised. Initially, the BIR's national office in Metro Manila was organised in seven divisions: administration, law, accounting, income tax and inspection, miscellaneous taxes, the office of the special agent, and one secret service section (Kang 1965: 189). While the BIR divided the Philippines into inspection districts, each maintained by a supervising agent, initially it did not collect. All internal revenues were collected by appointed provincial and municipal treasurers and their deputies. Their salaries were paid by local governments which diluted accountability to the national office (Stene/Waldbry 1956: 197). The later establishment of permanent internal revenue offices in the provinces extended the BIR's effective outreach. Following independence, BIR's inspection districts were reorganised and each of the 31 districts placed under the supervision of provincial revenue agents. Yet,

Assessment notices, unposted receipts, and other papers were literally piled up in filing cabinets, desk drawers and boxes, and on shelves, cabinets, and on the floor (Stene/Waldbry 1956: 199).

... many treasurers failed to submit their duplicate copies of receipts, sometimes assessment numbers were missing, and in the Bureau itself, many assessment notices were improperly filed or missing, and there were many unposted receipts (Kang 1965: 207).

As a result many taxes were never collected. Assessments were made and because of a lack of follow up were often forgotten and not paid (Radian 1980: 151).

Tax collection was inefficient. Hence, with the assistance of U.S. tax advisors, the BIR enacted a withholding tax system, established a collection group, and introduced tabulation and business machine processes. This served to improve business processes.

In 1955, the BIR established the first two regional offices, as intermediates between the national office and revenue inspection districts, in the Visayas and Mindanao. Each regional office was managed by a regional director, an assistant regional director, and five branch chiefs for administration, audit, collection, investigation, and legal. The BIR transferred tax collection powers from local treasurers to collection agents and clerks. National office reserved the administration of high value cases (Ramos et al. 1968).

By 1967, the BIR had created 20 regional offices and 90 revenue inspection districts nationwide. A commissioner of internal revenue, assisted by a deputy commissioner for administration, a deputy commissioner for operations, nine assistant commissioners,

and 34 division chiefs managed BIR's day-to-day operations (Das-Gupta 1998: 395). Of a total workforce of 6,000, about 1,150 collection agents and 850 collection clerks stood in direct contact with taxpayers (Kang 1965: 195).

President Marcos saw benefit in reforming the tax system. His purge of civil servants under the Integrated Reorganization Plan (see Chapter 5.2.2) affected about 450 Customs and Internal Revenue officers, including the Commissioners of the Bureau of Customs and the Bureau of Internal Revenue (FEER 07.10.1972, 03.10.1975). In 1975, President Marcos appointed Justice Efren Plana, reputed as a technocratic, honest and credible civil servant, the Commissioner of Internal Revenue. Marcos instructed Plana to tackle rampant corruption within the BIR. Not least tax administration reforms were prerequisites for Marcos to gain access to badly needed foreign loans from the International Monetary Fund and the World Bank. Both had the advantage that Marcos reigned by executive order alone and did not have to consult with the Congress. Commissioner Plana's reforms were far-reaching; he limited discretion and increased transparency.<sup>137</sup> In hindsight, observers described the Plana reforms "the most successful administrative reforms in the history of the BIR" (Fabella/Chua 2011: 205). They were not sustainable though; after Plana's departure in 1980 many problems re-emerged.

President Corazon Aquino had no choice but to start a comprehensive reform of the tax system. The focus was more on tax policy than tax administration reforms though.<sup>138</sup> Tax administration reforms served to enable the implementation of tax policy reforms. In 1987, EO 127 restructured the Department of Finance and its attached agencies. BIR headquarters was reorganized into an assessment and collection group, and a legal and administrative group. Later, the audit process was rationalized and an audit report evaluation committee created; the withholding tax system was expanded; and an in-house computer and communication network prepared (BIR AR 1989: 26). Reforms were comparatively successful, BIR's tax effort increased from 7.8% of GDP in 1986 to 9.7% of GDP in 1992 (BIR ARs). Yet, in hindsight analysing the 1972-1991 reform experience, Das-Gupta (1998: 382) concluded, "The Philippines is an example country that has not achieved effective reforms in tax administration, despite sporadic efforts".

In the 1990s, the Philippines wished to depart from IMF supervision. The Country Assistance Strategy in this regard emphasised the importance of tax reforms. Relatedly, the Philippines sought to pursue an ambitious national development programme, known as "Philippines 2000", which required substantial resources for implementation. President Ramos oversaw three major tax reform initiatives: The Tax Computerization

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<sup>137</sup> For a detailed account of tax administration reforms under Commissioner Plana see Briones (1979), Klitgaard (1988: 13-24, 48-62) and Fabella/Chua (2011: 205-208). For a discussion of technocracy under Marcos, based on the example of Finance Minister Cesar Virata (1970-1986), the chief technocrat during the martial law period see Sicat (2011) and Tadem (2012, 2013).

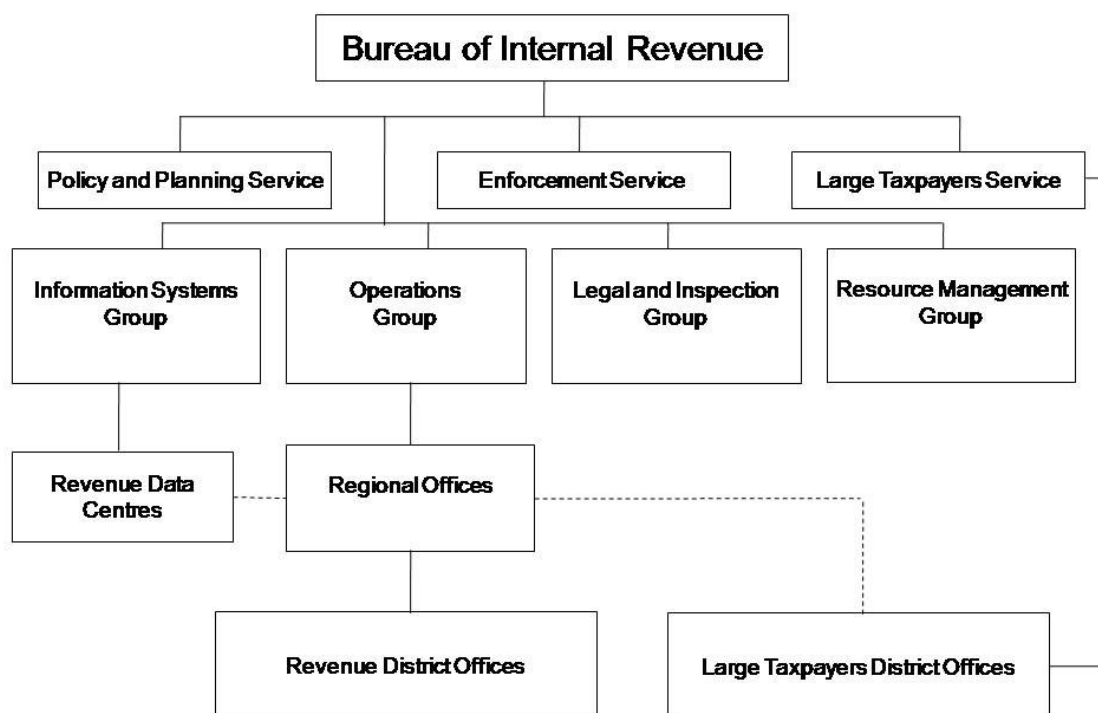
<sup>138</sup> For instance, Aquino's 1986 Comprehensive Tax Reform Programme, still by executive orders and without Congress participation, introduced 29 tax measures, including a 10% value added tax on manufactured goods, and a simplified uniform 35% personal income tax rate (Diokno 2005: 6-10).

Project (1993-1999), which with significant international financial and technical assistance, aimed at establishing an integrated computerised tax administration system linking regional and district offices to the national office. Project results however fell short of expectations (see Chapter 5.3.3). The second Comprehensive Tax Reform Programme (1997) followed an expansion of the value-added tax (see Eaton 2002) and the passing of a new “sin” tax law (see Guevara 1995). It targeted reforms in income and excise taxes, and the rationalization of fiscal incentives (cf. Diokno 2005). Again, results fell short of expectations. Congress only partly passed what the Department of Finance had desired (see Mendoza 2004).

The tax system was hardly simplified. “Congressmen, who were preparing for the 1998 general elections, had little interest in improving the tax system and were afraid to earn the ire of big business, which generously contributed to their campaigns” (Fabella/Chua 2011: 214f). BIR’s tax effort decreased rather than increased (see Table 5.5). In tax administration however a success was achieved: the establishment of the Large Taxpayers Service (LTS) in 1999/2000.

Earlier a Large Taxpayers Division had been enacted by RA 7646 in 1993, yet it took the BIR not only more than three years to establish it, but its functionality was constantly criticized. The IMF had demanded its replacement and the LTS’s introduction. Unlike the LTD which was under supervision of the Operation’s Group Collection Service, the LTS was placed under direct supervision of the Office of the Commissioner. The LTS however never met its collection goals. Critics claim that it had started with good intentions, yet met opposition both from the inside and the outside. Its initial strengths were steadily diluted.

Figure 5.7 shows a simplified structure of the BIR’s organisational structure.

FIGURE 5.7: *Organisational Structure of the Bureau of Internal Revenue (2000-2011)*

Source: Author's illustration based on Bureau of Internal Revenue, Executive Orders 175 and 306.<sup>139</sup>

According to the law, the BIR is under direct control and supervision of the Department of Finance. Some observers however suspect that in fact the tax authority is subordinate and accountable only to the president. It is said, that the secretary of finance has supervision over BIR operations, but effectively only little control. Hence, it is disputed whether the BIR is a semi-autonomous agency or not. This study perceives that so far it is not.

The BIR is a hierarchical, three-tier organisation. By 2000, it consisted of a national head office in Quezon City, 19 regional offices in the revenue regions (RR), 119 revenue district offices (RDO), four revenue data centres and two large taxpayers district offices. It is headed by a commissioner of internal revenue and four deputy commissioners, each heading one of the four major organisational groups of the Bureau, i.e. information systems, operations, legal and inspection, and resource management. The information systems group is in charge of providing services in the areas of information systems operation, development, planning and quality, and services revenue data centres. The operations group, is subdivided in the taxpayer assistance, assessment, and collections services, and oversees the regional offices and revenue district offices.

<sup>139</sup> For a BIR organization chart as of 1967 see Ramos et al. (1968: 63), as of 1987 see BIR Annual Report (1987: 61), as of 1993 see BIR Annual Report (1995: Annex).

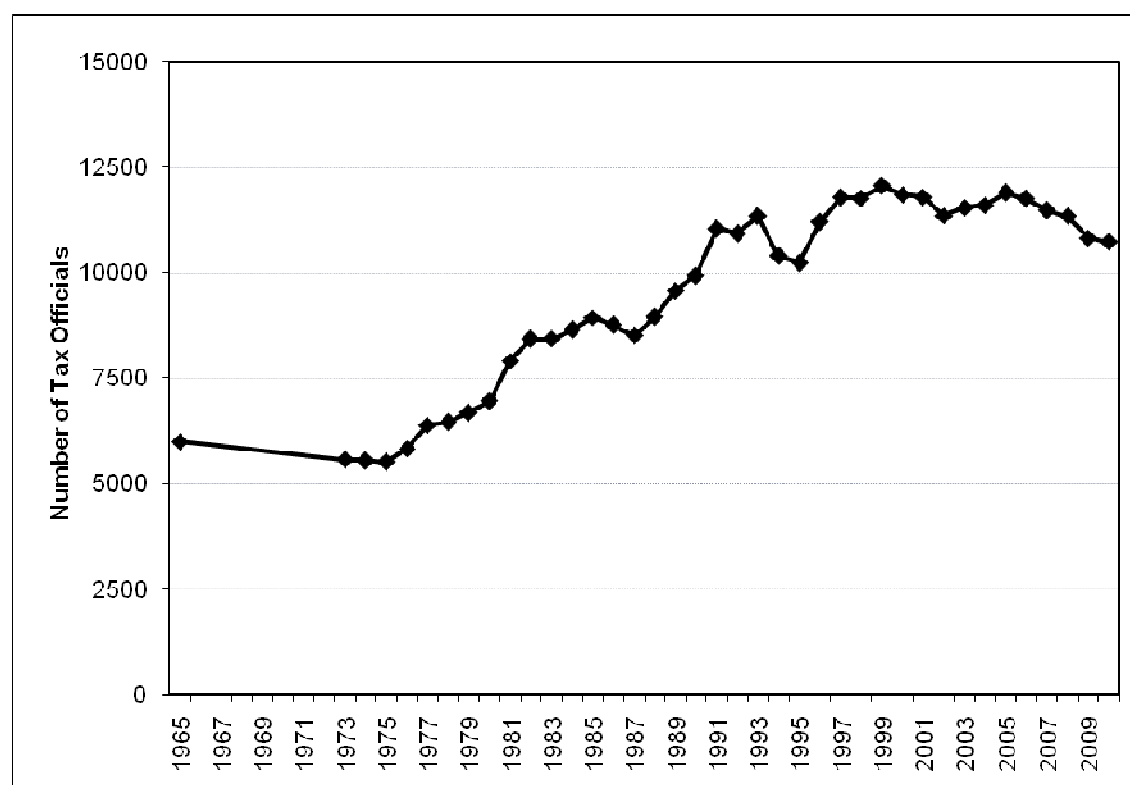
Legal issues and internal audits are the responsibility of the legal and inspection group. And the resource management group is in charge of human resource development, and financial and administrative services.

An assistant commissioner supervises each service. Only the large taxpayer service, policy and planning, and the enforcement service are under the commissioner's direct supervision. Regional directors oversee the performance of the administrative division, assessment division, collection division, finance division, legal division, special investigation division of regional offices, and supervise the revenue district offices within their office's jurisdiction. Revenue district offices perform frontline taxpayers services, including the auditing of taxpayers' accounts and accounting records.

The analysis has shown that the Philippines has a long history of formal taxation and of tax reform programmes. In the early years, the dominance of the colonial power has been pronounced. When Filipino tax officials took over control, they lacked sufficient training and were still very much embedded in the traditional feudal culture. Often traditional values overruled the modern value systems which legally formed the basis of the tax administration. Through the decades there has been much continuity; taxation has remained weak despite numerous reform attempts. Implementation hinged on executive power; many reforms were frustrated by parliament and tax officials who preferred to keep the status quo. Hence, there remains wide scope for reforms, yet comprehensive reforms are unlikely to be implemented. Pushing small measures through might even be a difficult undertaking.

### **5.3.2 Human Resource Management**

Staffing issues have long posed problems for the Bureau of Internal Revenue. As Figure 5.8 illustrates, the absolute number of tax officials employed with the BIR has grown only slowly. In 2010, the number of employees was essentially the same as twenty years earlier. With 11,500 employees on average over the last decade the BIR has been a small agency. In relation to Philippine population growth it is becoming increasingly understaffed.

FIGURE 5.8: *Size of the Tax Administration, Philippines (1965-2010)*

<sup>a</sup> Temporary, casual and contractual staff are not included, as their numbers are unknown.

*Sources:* Data for 1965 derived from Ramos et al. (1968: 51), for 1973-1981 from BIR Annual Reports as cited in Das-Gupta and Mookherjee (1998: 408), for 1982-2010 from BIR Annual Reports (various issues).

The Philippines' crude tax official rate not only failed to meet the international benchmark of one tax official per 1,000 inhabitants (Gallagher 2005: 137), but also declined steadily over the last forty years. The calculated ratio dropped from 0.19 in 1965 to 0.11 in 2010.<sup>140</sup> Relatedly, the number of registered taxpayers per tax official increased significantly. Thus, already by sheer numbers has been difficult for BIR staff to effectively and efficiently collect revenues.

The BIR's weaknesses in human resource management however go beyond understaffing. The Bureau does not always have the right people in place. Less than half perform core functions; lawyers, certified public accountants, and information technology professionals are in short supply. The BIR has difficulties attracting and recruiting the technical and managerial manpower needed, as the salaries and fringe benefits it offers for many are not only lower compared to the private sector but also lower than in some other agencies, such as the Central Bank and government-owned and controlled corporations (GOCCs). Underpayment is also perceived as a problem by private sector representatives as a FGD participant's comment indicates: "They are not

<sup>140</sup> For an international comparison see footnote 56.

getting their needs. They are not being paid well".<sup>141</sup> Low wages also make it difficult for the BIR to retain well-qualified staff. This presents serious governance risks. The turnover rate has been high. For instance

Lawyers don't really stay long. They are there for two or three months to gain experience and then they are getting out. And they say "I used to be at the Bureau" and they handle the tax side of the business. Just to increase their marketability. ... It doesn't mean that just because you worked in the Bureau, there's special preference for you. Of course not.... But it's a concept .... (FGD BIR).

The concept referred to above seems to be common among Philippine citizens. Many Filipinos believe that having personal contacts with people in the BIR is a valuable asset; it makes dealing with the tax authority easier.

Tax officials who stay on arrange with the system. Some seem to borrow against their salaries, as indicated by the observation that the ATM machines at BIR national office are regularly used by individuals who hold stacks of BIR employees' debit cards, others might regard absenteeism, returns from side jobs, e.g. as private tax advisers, and graft as legitimate, as part of the employees' compensation. According to Commissioner Guillermo Parayno (2002-2005) an inherent danger is that "Even if you put saints [in the bureaucracy], if the environment produces devils, those saints in due time will become devils themselves" (N 14.10.2002).

Elite intervention in recruitment, transfer and promotions of tax officials undermining the principle of meritocracy, and the particularistic instrumentalisation of these tax official positions further weaken the tax administration.

The commissioner, deputy-commissioners, assistant commissioners, regional directors and assistant regional directors are presidential appointees. For the other tax officials, well-established rules and regulations for recruitment exist. As the Department of Finance does not operate its own college to educate junior staff, the BIR directly recruits individuals, who already have completed the necessary graduate degrees and gained civil service eligibility, from the general labour market. Vacant positions are to be publicly announced, stating the salary grade and minimum qualification standards, such as educational requirements, eligibility standard, specific skills and work experience, required for the particular positions. Lateral entry is possible if the vacancy cannot be filled with individuals already employed with the tax authority. Applications are received in paper and administered by the Bureau of Internal Revenue's personnel division. Following initial screening, individuals are invited to pre-employment

<sup>141</sup> Since 1989, the salary standardization law (RA No. 6758) divides the salary schedule for civilian personnel of the national government in 33 salary grades, with eight steps each. To illustrate, most tax officials with a Bachelor's degree enter at SG 11, with a monthly base pay of P 18,000, a fiscal examiner is classified as SG 18 at P 30,000, and a deputy commissioner as SG 28 at P 60,000 (Communication with BIR 2009 and DBM (2011)). In addition, BIR officials may receive certain incentives, e.g. for performance, loyalty and allegiance; allowances, e.g. for clothing, cost of living, educational assistance; and confidential and/or intelligence funds, which can multiply the take home pay (cf. PCIJ 09.12.2012). According to the COA 2010 Report on Salaries and Allowances, the total annual amount of emoluments and benefits received by the CIR amounted to P 5.5 million, in 2011 only P 1.4 million, while the deputy commissioners on average received P 780,000 (COA 2011: 125; COA 2012: 173).



examinations, successful candidates thereafter are interviewed by the personnel selection board and undergo psychological testing, before a ranked list of suitable candidates is made from which the most qualified individual for the position is to be chosen for appointment. Officially, it is claimed that these processes and standards of meritocracy are strictly followed, and political recommendations are explicitly discouraged. Asked directly however even the most senior officials admit that until the present day the "MBA policy" might intervene.<sup>142</sup> While reluctant to say "for sure" that "powerful interests" get involved as "politics is messy and sensitive" an interviewee shared the following personal observations:

Every time we appear in Congress for our annual budget hearings we see congressmen with folders going to the commissioner of either the BIR or BOC. These folders are the CVs of people they want the commissioner for hiring in their agencies.

A high-ranking tax official explained what happens to these recommendations:

To a certain extent politicians do have an influence who is hired by the BIR, but for some time those who are in charge have not been accommodating them. There are candidates recommended by politicians, but we take those who are qualified, those who are not we have to politely tell the politicians: Sorry. We choose from the recommendations we got, but not all of those who are here have been recommended.

According to civil society representatives interviewed, in particular the powerful and the ones directly involved with collections are placed by influential personalities. For politicians the Bureau of Internal Revenue is a sensitive agency, having their clients placed at strategic positions within provides large potential rents and numerous benefits, for instance the value of tax assessments and audits against family members and friends might be lowered, or funds occurring at the BIR channelled to campaign accounts. For the BIR the placement of recommended is a matter of bargaining. In exchange, favourable legislation, budget allocations, and protection against hearings and investigations can be requested. In addition individual tax officials might reap personal benefit if they used the powers bestowed upon them in a particularistic way.

Allegedly, also those already employed with the tax authority try to position relatives or leave their position to someone close. According to a BIR Assistant-Commissioner

These hereditary groupings are probably less extensive, now then, say ten years ago, and they are more prevalent in the bureau's regional offices than in its central office. But instances of children inheriting posts from their parents at central office are noted (Hodder 2009: 775).

Loopholes in the official recruitment process might help this. For instance, the number of applicants is said to have been limited by delayed posting of vacancies, posting at the office pin board and newspapers with small circulation only, or not publishing the vacancy at all. The examination tool as such has been outdated: there are rumours that the same set of test questionnaires has been in use every year since 1969. Moreover, tests have been stored in an insecure place and a dedicated examination room has not existed, making the leakage of correct answers comparatively easy (Development

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<sup>142</sup> Standard reply letters declining politicians' letters of recommendations were developed twenty year ago already. According to tax officials they are still in use, but not used as standard practise.

Academy of the Philippines 2006: 94, FGD BIR). Another, possible route has been the hiring of consultants, contractual workers and *alalays*, i.e. of temporary assistance/support personnel. Tax examiners hired *alalays*, and paid them from their personal purse, to schedule appointments with taxpayers, prepare reports and memoranda on tax investigation results. Eventually, some of these individuals were absorbed and given permanent positions at regional and district level bureaus (MB 03.01.2011).<sup>143</sup> Stene and Waldby (1956: 208) pointed out that overall “the responsible administrative officials have almost no voice in the hiring and firing of subordinate employees”. It seems, in this regard there has been a large degree of persistence.

In placement, job rotation<sup>144</sup>, and promotion decisions, similarly, actual practises seem to be deviating from the formal policies, guidelines and procedures in place. While the qualifications of staff and the positions' requirements should be matched and appointments strictly based on merit, this has not always been the case. It is claimed, that in the past within the BIR a group controlled “the parcelling out of juicy posts to bidders” (Briones 1979: 263) and personnel scams had been systematised and widespread in the regions (Klitgaard 1988: 50). Jobs with considerable discretion and direct contact with taxpayers such as those of assessment officers, auditors and examiners, in particular in tax-rich regions such as Metro Manila's, have been very much sought after, as these are the positions where informal money can be made.

Politicians also intervene when they want to place someone into a particular position and also when they do not want an individual in a particular position. For instance, in the province of Cebu in 1963 the Bureau of Internal Revenue's collecting agent was the local Durano clan chief's nephew (Cullinae 1993: 210), revisiting the province more than 30 years later Sidel (1999: 103) came to the conclusion that the protégés and relatives of the Duranos still hold influential positions, not least in the BIR. Similar configurations can be found throughout the country, as a politician interviewed admitted: “It is prevalent, some are appointed to juicier districts or regions for political reasons.” Rumours are even circulating that certain district offices were established only to accommodate favoured individuals. It has further been reported, that for decades, promotions as regional directors and district officers to Metro Manila came with the privilege of bringing selected personnel with them, despite these plantilla positions belonging to the provinces (MB 17.02.2011). While this might have been reasonable in regard of the large number of wealthy Filipinos in Metro Manila, the move clearly raised the risk of abuse. To retain their preferred position, tax officials are said to

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<sup>143</sup> Allegedly, *alalays* have been paid between P 1.000 and P 2.000 weekly. On a monthly basis this would constitute a significant proportion of the tax examiner's official salary. These payments suggest that both parties do have additional earnings besides their official compensation.

<sup>144</sup> According to the Tax Code, tax officials are reshuffled every three years. In particular, those employed in assessment and collections are not allowed to stay longer in the same post to avoid the development of strong personal relations between them and taxpayers. However, rotation does not seem a regular practise, tax officials appear to be rotated whenever their superior sees it fit. Some tax officials stay longer, others significantly shorter periods. Notably, every time a new commissioner takes over, shortly after a larger reshuffle takes place, sometimes within only a few months followed by another reshuffle.

regularly provide favours to their 'backer' and bribe their colleagues at the local, regional, and national office.

Support positions such as in planning and positions in far-flung regions are regarded as the backwaters of the BIR, entrepreneurial tax officials would do anything to avoid working there. It tends to be either very principled individuals with a strong morale who choose to spend their career, or individuals who have done something seriously antagonizing the commissioner who are placed to "freezer positions", in these divisions and offices. Working there comes close to a stigma. Allegedly, tax officials might even fight promotion when this would mean losing additional opportunities, which would normally be much higher than the salary rise they could expect from promotion.<sup>145</sup> Unsurprisingly, these divisions are often understaffed, that is the number of staff employed is lower than the number of authorised positions.

Most tax officials nevertheless are regarded as somehow qualified.<sup>146</sup> However, with career planning under these circumstances being hardly possible, staff motivation and performance can be impeded. Some tax officials believed that the workload is unevenly divided between them. While some worked overtime many days and still struggled to finish their work, others were observed going to work daily but not doing anything, as they perceive they are backed by their MBA anyway. Other employees allegedly appear as "ghost employees" or "15-30 workers", coming to office only on the 15<sup>th</sup> and 30<sup>th</sup> of each month to collect their pay checks.

The older tax officials sometimes present a problem too. As noted by an interviewee

the older ones are still preparing their draft by hand and then make it type by the secretary. ... There are those whose services we also need ... but more of the older ones we do not really need them. At times they are just reading newspapers or pretending to do.

Underperformance has not carried the risk of serious consequences, as Philippine civil servants enjoy security of tenure. This makes it almost impossible to lay an officer off until he reaches the official retirement age of 65 years.<sup>147</sup>

Training is of critical importance for staff development, yet so far it has not been given the attention it deserves. For decades, the BIR national office has had a human resource development service and training delivery division. Several times a year, it has organised both general and specialised courses for tax officials. The large majority was offered at the BIR "National Training Centre" based at the national office's compound. Some training, often in collaboration with outside agencies such as the Civil Service Commission or the Commission on Audit, was conducted in the regions also. Closer analysis however indicates that the training offered consistently fell short of needs.

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<sup>145</sup> The salary structure does not help either, as the first step of the next higher salary scale is lower than the eighth step on the previous one.

<sup>146</sup> Data on the educational attainment levels of BIR staff are not available, making it impossible to at least discern the real qualities of staff and its development over time.

<sup>147</sup> Under special circumstances, it is possible for civil servants to retire at the age of 60. Yet, as retirement means a significant monetary loss, the large majority of employees would not want to do this. Allegedly, BIR officials use fake birth certificates to circumvent age-restrictions and stay longer.

During their career, only few tax officials have been able to participate in meaningful and comprehensive trainings. For many, training meant the annual participation in one-day seminars or workshops with informative character only. Whether a tax official was present and whether there has been some learning achievement was not monitored. Examinations did not take place. Performance evaluations, while prescribed, were not properly carried out as not to embarrass anyone. If training was required for a job what counted was merely the amount of training hours documented. As a consequence many tax officials lack updated knowledge and a common understanding of issues.

According to tax officials, the leadership of the Bureau is of high importance in determining the authority's short-term directions. The character of human resource management and business operations depend on the commissioner's guidance. Each commissioner reshuffles personnel and changes policies and programmes. Often the predecessor's programmes and projects are discontinued or left to wither by the successor. If a commissioner works by the written rules and regulations, the majority of staff would similarly do so. If a commissioner tends to view the formality of rules and regulations lax, staff would follow. Hence, the appointment of the "right" commissioner of internal revenue is crucial.

The history of Philippine commissioners of internal revenue is colourful. Under Marcos, the BIR had three commissioners. Since, the turnover of commissioners accelerated. From 1986 to 2001, five commissioners, and from 2001 until 2010, six commissioners took turns.<sup>148</sup> The average tenure of BIR commissioners decreased from ten years during authoritarian Philippines, to 2.8 years in the early years of the democratic Philippines, and 1.5 years under President Arroyo.

One might think that it is ultimately the president who determines the BIR's directions through his appointment power, yet past experience has shown that the choice of the commissioner often is not the president's alone. Past experience suggests that there are times when the president succumbs to external influence and interference. The turnover from CIR Liwayway Vinzons-Chato (1993-1997) to CIR Beethoven L. Rualo (1998-1999) presents a case in point. It illustrates well the interlinkage and power play between politics, business, and public administration, which surrounds the tax system.

Appointed by President Ramos, Commissioner Chato, a former private lawyer, oversaw the country's biggest tax evasion case filed in recent Philippine history. Lucio Tan, Chinese-Filipino businessman, former Marcos crony, and then perceived the richest Filipino, and his companies, notably Fortune Tobacco, were charged of allegedly having evaded taxes worth P 25 billion between 1990 and 1992.<sup>149</sup> The BIR claimed to have collected truckloads of evidence and took Tan to the courts. Throughout the years, higher levels were reached as the BIR won and lost cases again, amidst rumours that

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<sup>148</sup> Under Benigno Aquino so far only one BIR commissioner has served.

<sup>149</sup> Lucio Tan is the country's most prominent alleged tax evader. He owns or holds majority shares in many of the country's largest companies and enterprises, including Philippine Airlines, Allied Bank, Philippine National Bank, Pan Asia Securities, Foremost Farms, Asia Brewery, Fortune Tobacco, University of the East, and Eaton Properties (Lucio C. Tan Group of Companies 2009).

Tan would pay off justices for favourable rulings. Finally, it seemed the BIR would stand a good chance of winning its case. Yet, it turned out, that the end of Ramos' presidency also presented the end of Tan's tax evasion case. Lucio Tan, as he had already done for Marcos in 1986 and Ramon Mitra in 1992, generously contributed to Joseph Estrada's presidential campaign, as his long-time friend promised him to take care of his problems in case he won the elections.<sup>150</sup> And Estrada did as promised; he placed people associated with Tan in strategic posts to handle his case. Allegedly, Commissioner Rualo was handpicked by Lucio Tan himself. Soon, the case against Tan was announced "very weak" and likely to lose for "some kind of violation of due process". Rualo recommended the dismissal of the cases. Soon the two tax evasion charges against Tan were decided, based only on the companies' assertions of faith: "One 1987 tax assessment filed against Allied Bank for P 338 million was reduced to zero while another filed in 1993 against Fortune Tobacco for nearly P 8 billion was shrunk to only 5 million" (PCIJ January-March 1999). Moreover in 1999, at the Bureau of Internal Revenue's 95<sup>th</sup> anniversary celebration, Tan was awarded a plaque of appreciation for his "valuable support in the agency's tax collection efforts", after Tan had financed public relations material for BIR's tax campaign (BW 03.08.1999).

The struggle between Lucio Tan and the BIR is ongoing. Yet Tan is not the only obstacle to efficient taxation. Numerous other cases of similar impact can be found. The following chapters further elaborate these issues.

All in all, BIR's human resources present a serious challenge to its performance. The tax authority has been understaffed in absolute numbers and inadequately staffed in relative terms. Low salaries and unreliable career perspectives pose serious governance risks. Moreover, qualifications and merit formally govern recruitment, transfer and promotion of tax officials. Yet, often politicization and economic elite influence have been the stronger arguments for human resource management decisions taken. The commissioner of internal revenue is of high importance in leading the direction of the BIR and its staff. The commissioner's appointment is a matter of bargaining between the executive and vested interests. Overall, the rotation rate has been high. Reforms are pressing, yet circumstances appear more adverse to reforms than beneficial.

### 5.3.3 Business Operations

"BIR is not very efficient. It is doing poorly at this stage. There are structural reasons; there are many areas where it fails .... It is an organisation designed to fail". This statement by a social scientist interviewed sums up the informed analysis of tax administration in the Philippines in paper and practise. While in paper good practises exist, in implementation they tend to fail.

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<sup>150</sup> It is widely acknowledged that Tan donated about P 1.5 billion to Estrada's campaign funds and shared his sales distribution channels for Estrada's grassroots-campaigns.

*Reaching the revenue goal*

In Philippine revenue collection what counts most is that collection targets are achieved. How they are achieved is less of a concern. The Development Budget Coordination Committee assigns the annual collection goal; the BIR then allocates individual collection targets to its revenue regions, revenue districts, tax officials and employees (see Miral Jr/San Juan 2007). Throughout the year, then the principal interest of both the President and the Secretary of Finance in their monthly consultations with the BIR regards the discussion of revenues collected so far and the likelihood of achieving the target by the end of the year. The tendency has been to measure the BIR's standard of performance against the achievement of the revenue goals. The comparison of actual collections with revenue targets shows that the BIR between 1986 and 2000 exceeded its annual collection target only five times, i.e. in 1987, 1989, 1993, 1994, and 1996 (BIR ARs 1986-2000). Since 2001, the BIR achieved its annual collection target only twice, in 2001 and 2003 (BIR ARs 2001-2011). This means that the BIR missed its target 18 times within the past 25 years. As the tax target is defined by the executive, the constant underperformance of the BIR might suggest that the legislature interferes in tax collections (cf. World Bank 2011: 120f).

*The problem of tax exemptions, tax incentives and related benefits*

According to the 1987 Constitution, Article VI, Sec. 28, taxation in the Philippines should be progressive, uniform and equitable. Subsequent tax codes maintain these goals, but what appears progressive on paper, in practise turns out to be neutral or even regressive. In practise the low- and middle-income earners pay a larger share of taxes on their income than the high-income earners. For instance, the World Bank (2011: 12) estimates that self-employed and professionals only pay 20% of income tax, "even though they account for 60 percent of non-corporate income. The remaining 80 percent is borne by wage-earners. The top 10 percent of income earners in the Philippines reportedly only pay around 1.7 percent of their income in income taxes". Set aside tax evasion, the wealthy have more opportunities to avoid paying taxes.

Critical analysis of tax-related legislation of the last decades shows that Congress has passed more tax eroding than tax enhancing measures, resulting in government losing billions of Pesos each year.<sup>151</sup> Of the 38 revenue laws passed between 1992 and 1998, Diokno (2005: 15) evaluated 28 as having a negative revenue impact. Analysing revenue laws passed between 1998 and 2009, the Department of Finance's National Tax Research Centre (2011: 8) came to the conclusion that 46 of the 57 Republic Acts affecting internal revenues passed were also revenue-eroding measures. Other tax exemptions and incentives are administered by the Board of Investment (BOI) and the

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<sup>151</sup> It is estimated that revenues foregone could be as high as 1 to 2% of GDP (IMF 2012a: 13). A similar observation has been made in 1965 also: "From the standpoint of the politicians, it is more fashionable and more vote-worthy to work to cut or abolish taxes than raise them. Hence, the trend in the last few years especially has been to broaden the tax exemptions extended to certain sectors of the economy" (FEER 08.07.1965).

Philippine Economic Zone Authority (PEZA). It is estimated that about 180 tax incentive related laws and issuances are in effect (Nakayama et al 2012: 12). Legislators interviewed argue that tax exemptions largely address items “not worth taxing” and fiscal incentives were necessary to attract and encourage investments,

We give exemptions because we do not have the domestic power to finance all this. We have to attract foreign investors for infrastructure. We borrow money for infrastructure. We need the foreign exchange to pay for our loans. Otherwise nobody is coming here to finance our development.

Reside (2006) however showed that large amounts of incentives provided are redundant as they are given to many firms that would have invested anyway, even if they had not been granted incentives. It were not only foreign investors who were given special treatment, but many domestic firms, including some of the country's largest and most profitable about to undertake high-return on investment projects, and even specific groups and individuals. By ranking all BOI-registered projects from 1969 to the first half of 2006, the Philippine Center for Investigative Journalism found out that

Of the 10 companies that registered the biggest projects, seven are owned, controlled or run by some the Philippines' best-known family-based conglomerates such as the Lopezes, Ayalas, Gokongweis and Cojuangcos (PCIJ 14.08.2006).

Moreover, caused by weak coordination between the BOI and the BIR, and a lack of attention from tax officials, many recipients of tax incentives have been claiming tax exemptions far in excess of what they were granted and got away with it.<sup>152</sup> “The wedge between the taxation of companies benefiting from the maximum available tax incentives and those that do not—at 20 percentage points—is one of the largest in the world” (World Bank: 2011: 11f).

The establishment of export processing and special economic zones (ecozones), which allegedly can also be individual buildings and separate floors, further has frequently attracted criticism and controversies. Ecozones were introduced to promote economic development; therefore businesses located within have been offered preferential tax treatment, such as income tax holidays and a ceiling on tax payments to 5% of gross income. As throughout the years numerous senators and representatives began sponsoring bills for the establishment of ecozones in their home provinces, rumours and allegations emerged that the Philippine clans would disproportionately benefit.<sup>153</sup>

Several IMF country missions in diplomatic terms reiterated their warning that the “existing regime is very generous and unnecessarily complex” (Nakayama et al 2012: 12). The Department of Finance has long lobbied for a rationalization of tax incentives, but every attempt so far has failed. A finance official interviewed lamented:

Forty years ago until today, we have not been able to successfully do it. It is still pending in Congress right now and there is not a big chance for us to have a version which is what the DOF

<sup>152</sup> In 2004 the amount of excess claims might have been as high as the Department of Health's annual budget (PCIJ 14.08.2006).

<sup>153</sup> The establishment of the Aurora Special Economic Zone (2007) and its later expansion to the Aurora Pacific Economic Zone and Freeport (Apeco) (2010) pushed for by the Angara clan, despite harsh opposition of local communities, is a recent example (see PDI 26.11.2010, 21.09.2011, 21.02.2012).

wants to be passed by Congress. ... We continuously try to meet with legislators in the hope that they will be filing them and defending them during the committee deliberations. ... To seek partners and allies is a very difficult thing to do. ... The DOF also does lobbying, except that we do not have money. We do not call it lobbying, we call it "we shepherd our proposals in Congress". We have nothing to offer but a vision of economic growth for the country.

The Philippine "culture of tax amnesties" further complicates tax collections. Since the 1970s about 35 large-scale tax amnesty programmes were introduced as an incentive for taxpayers to pay their taxes (N 18.11.2006; Baer/Le Borgne 2008: 43-47). In exchange for the payment of a predefined share or amount of taxes, or advance tax payment, participating taxpayers were granted a variety of privileges and immunities, including waivers on unpaid taxes, administrative penalties and surcharges, no audits and investigations, and freedom from civil and criminal liabilities.<sup>154</sup> While in the short-term the tax take was indeed often increased, albeit relatively minimal, these tax amnesty programmes had the longer-term effect of being rather an incentive towards not paying the right taxes, as taxpayers could expect the next tax amnesty to be introduced soon.

### *The complexity of tax legislation*

The Philippines' tax laws are complex, constantly changing, and insufficiently accessible. It is Congress which passes the legislation, it is the Bureau of Internal Revenue which produces the implementing rules and regulations (IRR), it is the Secretary of Finance who produces Revenue Rulings (RR) upon the recommendation of the Commissioner, and it is the Commissioner of Internal Revenue or his/her deputies who, subject to review by the Secretary of Finance, pass the BIR revenue regulations (BIR RR).<sup>155</sup> No independent body exists tasked to check the consistency in between laws, IRR, and RR. A large degree of discretion has been left to tax officials.

Finding relevant rules and regulations is a difficult undertaking, even for the tax expert, let alone the ordinary citizen. A business representative interviewed critically pointed out:

We did not have an official tax code since 1997. The amendments that were issued or passed after 1997 were not incorporated in a book, a tax code published by the government. There are many tax codes in the bookstores, but they are dated, published by private companies. Revenue regulations, which are issued to implement the tax laws, are not updated and consolidated. There are amendments issued every now and then but it is not easy to keep track of them.

### *Tax rulings and opinions*

Being able to argue one's case is not sufficient in the Philippines; in tax assessments and tax audits much depends on interpretation. Different tax officials can decide the same

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<sup>154</sup> For instance in January 2005, President Arroyo with EO No. 399 directed the BIR "to Establish the 'No Audit Program' (NAP) for the Purpose of Enhancing Tax Compliance and Increasing Tax Collections", which should be in force for taxable years 2004-2008. Taxpayers who paid at least 20% more income taxes than the previous year were guaranteed exemption from audits and investigations.

<sup>155</sup> Other administrative issuances relied upon when interpreting the provisions of the NIRC include, revenue memorandum orders (RMOs), revenue memorandum rulings (RMRs), revenue memorandum circulars (RMCs), and BIR rulings.



case very differently, while still righteously claiming to adhere to the rules. As noted by an international organisation representative interviewed,

The tax code is so complicated to the point that for every issue you can actually find two rulings. One that would say it is taxable; another that would say it is not. ... It basically leaves a lot of discretion in the tax administrator, which one of the two he would believe in. A lot of times it will swayed by how much money you are going to give.

A particular problem are the tax rulings and opinions issued by the Commissioner of Internal Revenue and his appropriate subordinates, including the deputy commissioner for legal and inspection, the assistant commissioner for legal and regional directors nationwide, for the effective enforcement of the tax code. The filing of a request for a ruling is largely up to the taxpayer, while the discretion to enter a ruling process is up to exclusive and original jurisdiction of the commissioner. The number of tax rulings issued annually is unknown. For 1999, the Commission on Audit (1999: 1) in its audit report of the BIR estimated that 2.500 rulings and opinions interpreting provisions of the National Internal Revenue Code provided upon the facts and issues stated by the taxpayer were prepared by BIR officials and employees. For the same year, official numbers speak only of 1.100 numbered, value-added tax, international tax affair division, and delegated authority rulings (USAID 2006: 1/18).

Such discrepancy already points to serious problems and weaknesses related to the Philippine tax ruling system. They go further: a particular ruling is only valid for the taxpayer it has been issued to; it cannot be applied directly to another taxpayer. Moreover a succeeding commissioner can any time revoke a ruling issued by his predecessor. He can reverse the opinion and disregard it arguing that facts have changed. Taxpayers do not have a guarantee that their taxes will be assessed consistently throughout the years. Taxation is inconsistent and unpredictable. Moreover, as a business representative interviewed complained,

sometimes when the opinion might have resolved in lower taxes being due from the taxpayer that opinion can intentionally be withheld or delayed or put off for a very long time, for one primary reason, the government needs taxes and government needs private sector to first pay the taxes and they dispute it later. That is a very common situation.

Such particularistic decision-making is possible as the system is organised as such that tax officials are overburdened, little information is exchanged between different offices, and little can be traced back. The issuance of tax rulings is largely a manual task, binding procedures and guidelines for the preparation of tax rulings do not exist, not even national office holds a complete collection of tax rulings issued nationwide. Regional offices do not necessarily share their rulings with other offices; similarly they do not receive all rulings issued elsewhere. With an abundance of rulings existing in hardcopies only, there is no way to monitor, to track violations of policies, find inconsistencies, and taxpayers' histories (USAID 2006).

*Computerization*

The US\$ 63 million Tax Computerization Project introduced during the Ramos presidency, alluded to in Chapter 5.3.1, has not brought the results expected. By late 2012, the BIR still did not have a fully computerised integrated tax system. The World Bank judged the project satisfactory in programme assessment and the provision of hardware and development of software, but rated it unsatisfactory in implementation. According to the implementation completion report (World Bank 2000: ii, 8), after seven years “the computerization has not yet had significant impact on revenues ... its objective was too ambitious and the project was too complex”. The project experienced frequent turnover in high-level management, lack of support at middle management, and active resistance among BIR staff (World Bank 2000: 20). To illustrate, out of the software’s 14 module applications developed by external contractors, only between four and six “harmless” modules ended up being used by the tax officials, others like the audit functions were dropped due to internal and external resistance.

In subsequent years, little investments were made, leaving many offices with none or outdated computers, rather than increasingly computerised and automated tax administration. By 2003, of the BIR’s 116 revenue district offices only 43 were computerised. Moreover, being computerised did not necessarily mean that the computers were actually used and data fed into the system (ADB 2003: 55).

*Taxpayer registration*

The taxpayer registry has been a long-time problem. There has been little incentive for taxpayers to register and there has been little drive from the tax authority to boost registrations. While the BIR had introduced taxpayer account numbers (TAN) as early as the late 1970s and replaced these by taxpayer identification numbers (TIN), which were made a requirement for various business transactions, such as property and vehicle registration, in the early 1990s, the BIR so far has never had a comprehensive, reliable registry database.<sup>156</sup> Not only do many Filipinos not have a TIN, but some taxpayers have been registered with multiple TIN, and other TIN in the system do no longer belong to an active taxpayer. Data within the system further has been of minor quality.

*Loopholes in tax administration*

Most tax returns were handed in as hardcopies, manually processed, and then piled and stored at the respective local tax office. Direct face-to-face interaction between taxpayers and tax officials has been the rule. Many taxpayers, in casual conversations with the author, described paying taxes as unpleasant. They complained: if one is already forced to pay, it should be made easy, but the tax return forms are complicated, the queues are long, and the tax officials unfriendly. For instance, BIR employees would take breaks when there was no break time, every single page of documents

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<sup>156</sup> “The TIN comprises of a 9 to 13 digit numeric code where the first 9 digits is the TIN proper and the last 4 digits is the branch code” (BIR RR 7-2012: 2).

attached to the tax return was stamped, and authorised agent banks' opening hours for tax payments were insufficient. Also the author, visiting several revenue district offices in Metro Manila, gained the impression that BIR facilities were unsatisfactory for taxpayers and tax officials alike. Offices were cramped; fittings and furniture had seen their best days.

According to a social scientist interviewed, in document processing only 10% of data asked for in income tax returns have been captured by the local tax offices "how much tax was due, what they paid, and something else. You cannot make any decision about that. Even in the implementation of something very simple, there is a major flaw". With flaws in the taxpayers' database, the BIR could do little systematic analysis, planning, and monitoring. Numerous tax returns have not been processed; allegedly, lost tax returns have been a further frequent problem. Nobody was able to prove whether a tax return was really filed.

Similarly, audits have suffered from a lack of automation. Allegedly, the BIR only has "about 60 auditors that went through the training of computer-aided audits" (Interview: Social Scientist). Without sufficient available data and thus the lack of a good audit strategy, taxpayers were audited at random. The selection of cases to be audited was left to the discretion of district and regional officers, who had to adhere to broad guidelines, but no clear selection criteria. At the end of a fiscal year, in particular during March and April when reaching the tax collection target was at danger, tax officials were said to go on a field audit spree. In 2000, about 35.000 taxpayers out of 10 million were audited (World Bank 2000: 11). In audit, an ensuing issue has been the lack of data.

### *Data management*

While several laws encourage the exchange of data within the BIR, with the Department of Finance, and also with third-parties, the actual degree of exchange has been limited. Due to the Bank Deposits Secrecy Laws, the BIR has not been able to look into bank accounts. Both peso and foreign currency deposits remain strictly confidential. This lack of transparency has been widely criticized as an enabler of tax evasion and money laundering and for significantly hampering anti-corruption efforts. Reform attempts under the Ramos presidency proposing to relax the prohibition were opposed by business, commercial banks and many politicians, thus quickly died down.

Other information from external sources that had been available has hardly been systematically utilised and even the information submitted by the taxpayers has never been made proper use of. Within the Department of Finance and its agencies, and even within the Bureau of Internal Revenue itself, different estimates and numbers on similar issues exist. Apparently, the culture of sharing data is not very institutionalised. Sending requests and even instructions to the district offices for submitting specific data to the national office often is not very successful. The safest way to obtain data has been to personally collect it from the various offices, but even then one could not be sure of

really obtaining what is needed. A finance official described the problems they experience when asking the BIR for data:

At times it is difficult for them [the BIR] to provide data. There are certain constraints, like the confidentiality rule, for statistics to reach central office takes some time, sometimes the people at the central office do not have any control on the quality of information that is submitted to them. Sometimes in our analysis we find that the data does not look sensible does not seem right. Even the people at BIR's statistics unit sometimes do not have the answers why this is the case. Sometimes they do not want to hand out information as they are not sure of how valid or correct the information is. We are not in a superior position so that we can request any data we like. The Department of Finance would be in that position, but sometimes even the people from the DOF have difficult time getting information. We depend on good relationships.

A similar experience motivated a social scientist interviewed to describe the BIR as "a fortress":

You cannot get anything; ... nobody is responsible. ... They do not give it. Oftentimes they are maybe really not able to give it in the first place. They do not have the system to generate the findings required.

In particular tax officials employed at the policy and planning units express concern about the BIR's weak information base. Data is often incomplete and very little is available in digital format. Without the possibility to forecast, monitor, trail, and track, tax administration operates through a veil of darkness.

### *Vicious circle of distrust*

Taxation has been a contested issue, with all parties involved not trusting the other. The interviews revealed that taxpayers felt "harassed" by tax officials, middle level tax officials felt "harassed" by their superiors and believed taxpayers were not honest, senior tax officials felt "harassed" by politicians, and politicians felt "betrayed" by tax evaders and corrupt tax officials (FGD BIR, Interviews: Business Representatives, Politicians). The general claim has been that shortages in revenue collection were not their fault, but caused by the other. For instance, a businessman interviewed said:

There are dishonest taxpayers and dishonest tax administrators. There are exceptions, when business forces the issue, most businessmen would rather not have to bribe. They are forced by the bureaucrats.

Along similar lines a tax official interviewed argued, "Right now at the streets, the activists seem to be misguided, they want to enjoy the benefit of having taxes, but they do not want to pay taxes". Another interviewee claimed, Filipinos knew little about taxes and had low tax morale.

A senior tax official discussed the influence of politicians on tax collections:

Politicization of course affects us. Not just in "Oplan Kandado" [BIR's padlocking programme] even in the regular audit. Some taxpayers tend to go to politicians and the politicians would tend to go to our revenue officers and say "Could we just lower the assessment or cancel it?" -- favoured cases. ... The interventions from the politicians really affect their [BIR staff in field operation] collections. Some of them are really very serious about doing their work, but then they find out that this is connected, a relative or a friend of an influential person, then they cannot do anything about it, because they could be threatened, "Ok, I will tell you to a higher up and you could be removed from your post".

Having Filipino tax officials talk about internal challenges is very rare. Many tax officials asked for an interview or a statement graciously declined.

### *Tax negotiations*

It is uncontested, that “taxes” to a large degree have been a matter of negotiation and persuasion. As a matter of fact, taxpayers and tax officials have seen bargaining and direct collusion as a normal element of business life. The arenas of negotiation range from the commissioner of internal revenue down to the local tax examiner. Amounts involved tend to be higher the more senior a tax official, while the frequency of tax negotiations increases the more regular direct contacts between tax officials and taxpayers are. Tax negotiations are opened from both sides, with taxpayers under-declaring and tax officials doubting the accuracy of the taxpayer’s tax return. What a tax official described thirty years ago is still common practise:

The two most effective means of getting the taxpayer to come up here and answer our questions is first a personal visitation by one of our examiners, and second an arbitrary assessment: we choose some of the most obvious errors on the return, increase the assessment and mail a deficiency assessment notice; the next thing you know the taxpayer comes running up to protest (Radian 1980: 131).

As the following stories of business representatives interviewed indicate, these are the rules of the game taxpayers understood and follow:

You can’t win an argument with them [the BIR]. If you go to court, they will not give you your clearance until many years later, so that they wear you down. Some people say, I would rather not pay them anywhere, just give him 7% and then I saved money. It does not pay to be honest. Even if you wanted to pay your taxes honestly, they would still harass you. You almost have to mis-declare, so that you leave something for the tax administrator, so that not a completely fictitious charge is created. Sometimes, they are under pressure to produce results, to find fault, even if there is no fault, so you give yourself a small fault, so that you pay that fault and they do not harass you for something that is fictitious.

Only an insane person would pay proper taxes. No one declares the right one. That I am one hundred percent sure.

Allegedly, against the BIR’s handbook on audit procedures and techniques, negotiations at times start immediately, without the tax officials having examined the taxpayer’s books of accounts, records, documents, and business forms. The taxpayer knows how much he is willing to pay at a maximum, while the tax official knows how much he needs to raise to meet his collection target. Negotiations revolve around these two benchmarks. According to Bacalla (PS 17.04.2000) bargaining can lead to a reduction of up to 90% of a taxpayer’s liabilities. Often these negotiations were labelled as informal conferences. Proceedings were either not documented at all, or if partly documented this was only on paper. Without detailed documentation which is widely accessible third-parties would not know what the agreement is, how that was reached, and not be able to investigate whether the official rules and regulations were followed.

Taxpayers have not been treated equally. A lot has depended upon a taxpayer’s capability to negotiate, the bribe he is willing to pay, and the contacts he might have.

Many taxpayers have thus been availing themselves of the assistance of professional tax advisors and consultants. It have often been former BIR employees who chose this profession, but sometimes even those still active have provided tax advice as a side job. As retired tax officials maintain links to their former colleagues, who might owe them favours e.g. for having been promoted, it is expected that negotiations proceed smoother.

Tax practitioners that usually deal with the BIR will have contacts. Of course it is easier to deal with an organisation if you know the right contacts. But contacts are not the only thing that is needed, you also have to have sufficient grounds to be able to argue your client's cases, but indeed it helps (Interview: Business Representative).

Moreover, it might be advantageous to maintain close contacts with politicians. Allegedly, they are not only able to pass legislation in favour of specific groups and individuals, sin tax laws present a classic example, but also to help their relatives, friends, and sponsors to avoid paying taxes, to reduce assessments, and audits to be dropped. As acknowledged by a politician interviewed:

The influence of powerful individuals usually is very visible. If you don't pay your taxes, you are able to buy the congressman.

Tax officials fear going to certain areas, such as excise and mining, because of the political condition. As a matter of principle they would not tax certain individuals, such as governors and criminals (FGD BIR). "If there is political intervention, no tax administrator can enforce tax laws to the maximum" (Kang 1965: 213).

According to businessmen interviewed and individual taxpayers talked with, tax negotiations with BIR officials are unpredictable. "Sometimes it is a fifty-fifty share, sometimes it is eighty-twenty, depends on how greedy the official is or how extensive the network that he has to support". Moreover, the delivery is not guaranteed. Whatever agreement one has reached with one official, it may be revoked by the other, either immediately or a few months or years later. One is never sure that a case has been closed. Tax officials themselves, while admitting that tax negotiations have taken place ever since, were unwilling to share details on this issue.

In summary, Table 5.2 describes frequent types of integrity violations in tax administration, common mechanisms, stakeholders and related popular Tagalog expressions.

TABLE 5.2: Integrity Violations in Taxation and related Tagalog Terms

Types		Common Mechanisms	Stakeholders
Tax evasion <i>palsipikasyon</i>	Tax reductions	Taxable income/transactions that are intentionally not reported/ under-/ or overreported in accounts.  Several ledgers are used, including one for taxation purposes that may show a deficit/overpayment.	Taxpayers

Tax collusion			
<i>arreglo prosyento</i>	Tax reductions	Taxpayer and tax official negotiate tax liabilities.	Taxpayers Tax officials
<i>rebateh pampadulas</i>	Tax exemptions	Taxpayer is not registered in the tax registers, but pays a lower tax 'privately' to tax collectors. Taxpayer and tax official negotiate payments to avoid fines and penalties.	Taxpayers Tax officials Politicians
<i>kumisyon palakasan</i>	Tax reductions Tax exemptions Special treatment	Taxpayer and tax official negotiate tax liabilities and/or services via a third-person.	Taxpayers Tax officials Intermediaries
<i>barkada</i>	VAT fraud	Falsified claims for VAT refunds that occur with the help of collaborators.	Taxpayers Tax officials Fictitious companies
Tax corruption			
<i>SOP pang-merienda pang-hapunan</i>	Extortion	Asking for payments for services which should be free of charge.	Tax officials
<i>lagay barya-barya</i>	Extortion	Payments for faster services/procedures.	Tax officials Taxpayers
<i>pangingikil panggigipit</i>	Large-scale extortion	Taking advantage of taxpayers' incomplete knowledge of tax legislation, tax officials threaten taxpayers to pay above rates.	Tax officials
<i>tongpat</i>	Embezzlement of collected revenue	Tax officials steal money collected.	Tax officials Bank employees
<i>consortium</i>	Fraud	Falsifying tax receipts.	Tax officials Authorized printing houses
<i>suhol</i>	Corrupt inspectors/auditors	Inefficient and/or corrupt internal auditing.	Tax officials External parties

Source: Author's compilation, partly adapted from Fjeldstad (2005: 6), Klitgaard (1988: 19-21).

### 'Booty sharing'

As regards the subsequent distribution of illicit profits gained within the Bureau no conclusive evidence could be found. Tess Bacalla (PS 18.04.2000) argued, that the "PR", i.e. the informal public relations fee for the tax officials' purse, which regularly surpasses the "RP", i.e. the revenues raised for the government purse, is regularly shared among tax officials to a common scheme. The proportion of cuts would vary from office to office, e.g. in one office it was common that 30% were for the group of examiners assigned to the taxpayer audited, 15% for their supervisor, 20% each for the division chief and the assistant chief, and the remaining 15% passed on to more senior

officials until the highest level of the BIR was reached. Another informant maintained a 70-30 scheme applied: 30% for the supervisors and examiners, 10% for the assessment division of the regional office, 30% for revenue district officers, and 30% for the regional director who might share with his superiors. Only when external intervention at the highest levels is involved the bribe was not shared but kept by the tax official approached.

The impression gained during the interviews differs from Bacalla's account. It appeared that the procedures rather depend on the amounts involved. As large taxpayers tend to deal with point persons, often at national office, it can be assumed that profits are shared according to predefined percentages from the highest levels of the BIR who instruct, to the lowest levels that carry out the instructions. Medium taxpayers tend not to have and small taxpayers do not have a point person, instead they have to deal with various tax officials. Sharing in these cases seems to be less organised, meaning that 'successful' tax officials might invite to a celebration and/or put envelopes in their colleagues' desk drawers, or in case of small amounts not to take place at all, which may mean that at every desk along the taxation process some 'below the table taxes' need to flow. With policies in the BIR changing ever so often leaders change, one can assume, that it is also the sharing scheme, in particular with regard to the share between managing staff and executing staff, that changes, but that sharing in one way or the other is likely to be a "standard revenue regulation".

Yet, the common opinion is that not all illicit payments received are used for personal gain, some is spent on purposes perceived "legitimate". Tax offices, both in Metro Manila and in the regions, from time to time are said to run out of office supplies, such as printers, toners, paper, or even pencils, and require renovations to make the time spend at the tax office more pleasant for tax officials and taxpayers, leaving staff, as they say, with little other choice than to provide on their own or pay for it from the informal office kitty. Other funds are spend on recreational activities, staff outings, and regular lavish celebrations with food, drinks, and gifts for everyone at the Bureau's anniversary, the commissioners' and directors' birthdays, and other special occasions. By keeping everyone happy, the organisational culture of the BIR as being a big family, with all the privileges and obligations involved in this concept, is fostered.

The analysis of BIR's business operations has shown that tax administration in the Philippines in many ways diverges from what internationally would be called good practises. Partly, the reasons are to be found externally, partly internally. Elite influence on the tax administration is strong. The greater part of the tax legislation passed by Congress either eroded revenues or left large discretionary room for later negotiations. Tax administration itself has not been organised to be transparent and effective. There is significant room for reform, but as many shortcomings appear to have been deliberately created, getting these through is a challenge. As the following chapter will show significant benefits for vested interests have been related to these shortcomings.



### 5.3.4 Administrative Accountability

Filipinos described the BIR as the flagship of corruption, a notorious sinkhole of corruption, a cesspool of corruption or alternatively a heaven for corrupt officials. Many regarded the career as a tax official as nothing honourable, but a profession associated with the mafia, criminality, riches and wealth. "For centuries, the prevailing image of taxation was one of oppression, coercion, and subjugation" (BIR 2009c: i).

#### *Extend of Corruption and Collusion*

The 1999 Social Weather Station's Survey asked Filipinos on their opinion of graft and corruption in the public service.<sup>157</sup> More than 90% of respondents believed that there is graft; asked about its extent almost 40% reported a great deal. The Bureau of Internal Revenue, in this and subsequent surveys, along with the Department of Public Works and Highways, National Police, Bureau of Customs, and the Department of Education, was consistently ranked among the Philippines' most corrupt government agencies. Even higher than among the general public is the perception of graft in the public sector with managers and entrepreneurs (SWS 2007).<sup>158</sup> A stunning 98% of business representatives surveyed reported graft; more than 60% perceived there to be a lot, 25% some, and only 10% a little. They ranked the BIR among the country's most corrupt, most inefficient, and most insincere agencies in fighting corruption. More than half of the respondents admitted personal experiences of bribery in income tax payments. In tax collection about 40% of the respondents believed that more than 50% of government funds are wasted due to corrupt practises, 35% suspect a leakage of 30% to 50%. The large majority believes that both tax officials and taxpayers are to be blamed.

International surveys come up with comparable perceptions and estimates. In Transparency International's Global Corruption Barometer (TI 2004) the tax revenue system on a scale ranging from 1.0 (not at all corrupt) to 5.0 (extremely corrupt) was scored at 3.8, being slightly less corrupt only compared to the police, parliament, and political parties. According to the Global Competitiveness Index it has been extremely common for firms to "give irregular extra payments or bribes connected with annual tax payments". In 2001, the Philippines in this category was ranked 74<sup>th</sup> out of 75 countries, in 2002, 77<sup>th</sup> out of 80 countries (World Economic Forum 2001: 406; 2002: 615). About 60% of respondents in the World Bank's 2000 World Business Environment Survey regarded tax evasion as a normal practise in the Philippines; more than in any other neighbouring country surveyed (World Bank 2001: 10). Taxation ranks among the three most severe constraints on doing business in the Philippines (World Bank/IFC 2003).

Most interviewees with regard to the integrity of tax officials believed,

<sup>157</sup> SWS is a local not-for-profit social survey institute aimed at generating independent data on Philippine economic and social conditions. The survey interviewed a statistically-representative sample of 1,200 household heads nationwide.

<sup>158</sup> The SWS Survey of Enterprises on Corruption collects the opinion of 700 Filipino managers from different business sectors nationwide. Two-thirds are managers from small- and medium-sized enterprises, one-third from large enterprises.

that 10% are untouchable, super-clean, unquestionable integrity, so do not even bother to bribe them, 10% are hopelessly corrupt, and 80% belong to those who will not ask, but who will also not reject and who can look the other way while certain things are dropped into their drawers (Interview: Business Representative).

This observation is consistent with the results from public opinion surveys. It indicates that 90% of tax officials are open to tax negotiations and the acceptance of illicit payments, but suggests that it is a minority that is responsible for the worst headlines.

Relatedly, addressing Filipino citizens, Leonor Briones, former Treasurer (1998-2001) and Professor of Public Administration and Governance at the University of the Philippines, accused: "Tax avoidance is routine. Tax evasion is common. Non-payment of taxes is not really considered a bad thing. The attitude is that if we can't avoid death, at least we can avoid taxes!" (BM 10.04.2011).

There is sufficient evidence that loopholes in the tax system and in business processes have been frequently used, and also that this has resulted in large tax leakage. Due to its illicit character, a lack of data, and different methodologies, the amounts lost can only be 'guess-timated'. According to the civil society think tank 'Action for Economic Reforms', quoting an unpublished paper by the Department of Finance, in the fiscal year 2001, it was expected that the government would fail to collect more than 60% of the tax potential. Leakages on the various taxes were estimated to amount to: individual income tax 73%, corporate income tax 40%, minimum corporate income tax 88%, and value-added-tax 50% (Sta Ana III 2004: 3). Transparency International came up with comparable figures. It suspected that of every P 2.000 of taxes due, only P 1.000 were collected; P 500 lost to corruption, and P 500 lost to inefficient tax collection (Coronel 2004: 8). The research division of US-based investment bank Morgan Stanley believed that the Philippines loses the equivalent of 10% of its GNP annually due to widespread corruption, a complex tax system, and inefficient revenue collection (PDI 02.09.2002). Tax gap and tax leakage analyses from the National Tax Research Center (e.g. NTRC AR 2004: 29f) and the Philippine Institute for Development Studies (e.g. Manasan 2002) come up with only slightly more moderate calculations. The perception of large leakages continues to persist.

#### *Internal and external accountability mechanisms*

Interviews elicited that in regard of taxation in the Philippines, two forms of accountability have to be distinguished: First, 'negative' accountability which encourages the acceptance of tax avoidance and tax corruption; and second, 'positive' accountability which is targeted to contain these practises. Both can origin from internal and external accountability mechanisms.

#### *'Negative' accountability*

Within the BIR a "live-and-let-live strategy" has prevailed. Corruption has had a long tradition; few officials seem willing to take strong active counter measures. For many

tax officials the perceived costs are too high. They worry external interference and fear to be side-lined, to lose their job, to be taken to the courts, and even to lose their life.

In particular at lower career levels, these perceptions can manifest themselves in over-conformity with the prevailing attitude, even if these tax officials know that what they do actually does not make sense or is wrong. According to an international organisation representative interviewed:

People are very scared to go against political appointees despite the fact that they might be making decisions that are irrational as well. ... If a political appointee makes a decision that is clearly wrong, it is very difficult for the civil servants to challenge them. They have to know which way the political wind is blowing and they have to be very political. ... Can you afford to be a whistleblower? You cannot because you would lose your job. There are all sorts of losing your position, being pushed out, transferred,... Those sorts of issues come up quite often.

Stories of serious cases which can be interpreted as fight-back or retaliation action are hidden in BIR's history: For instance, former CIRs Bienvenido Tan and Liwayway Vinzon-Chato were confronted with graft allegations and damage suits after dealing with "big-fish". Allegedly, these were in Tan's case Eduardo Cojuangco and in Chato's case Lucio Tan (see Chapter 5.3.2; N 04.04.2001a, 04.04.2001b). It took years until Bienvenido Tan was acquitted; the case against Chato seems to be ongoing. (MB 18.08.2005; BW 09.02.2009). Moreover, during the last decade, at least four tax officials were shot dead in the streets. These included a head of the BIR tax fraud division, a revenue district officer and a document processor. While perpetrators and the motives for the murders remain unknown, it has not been denied that they might have been related to the victims' work (NST 17.10.2003; NYT 26.10.2003; PS 26.03.2011).

#### *'Positive' internal accountability*

According to the 1987 Constitution,

Public office is a public trust. Public officers and employees must at all times be accountable to the people, serve them with utmost responsibility, integrity, loyalty, and efficiency, act with patriotism and justice, and lead modest lives (Art XI, Sec. 1).

Tax officials are expected to adhere to related civil service regulations and observe the Bureau of Internal Revenue's Code of Conduct. Yet, for many decades deviations were hardly investigated, let alone sanctioned. The BIR's internal audit/inspections department, tasked to manage personnel integrity programmes and conduct investigations into allegations made against tax officials and employees, is said to have been understaffed, under-qualified, and under-funded. Allegedly, also the majority of their staff has been reluctant to pursue cases against their colleagues. Until the 2000s, the public has heard hardly anything of the department.

Similarly, the mechanism of hierarchical supervision has been flawed. As discussed earlier, directions change with the change of the commissioner of internal revenue. Organisational standards, except for the supreme importance of revenue goal achievement, have not been stable. Performance discussions have focused on tax target

related issues, other performance-related issues tended to be neglected. All tax officials received high gradings.

*'Positive' external accountability*

The Commission on Audit (COA), as the Philippines' supreme audit board, holds the mandate "... to examine, audit, and settle all accounts pertaining to the revenue and receipts of, and expenditures or uses of funds and property, owned or held in trust by, or pertaining to, the Government..." (1987 Constitution, Article IX-D). The COA and the BIR disagree on the interpretation of the mandate in regard of revenue audits. The BIR has been denying state auditors access to tax records, including tax assessment notices, tax returns, and compromise agreements. According to the BIR, these documents are confidential: Permitting COA access constituted an encroachment upon the tax agency and moreover in effect translated in an audit of the taxpayer which is legally untenable. With Resolution 95-208, the COA reasserted its powers and duties for a full revenue audit. Yet, despite subsequent involvement of the Supreme Court and an Executive Order strengthening the COA, due to strong BIR opposition it remains unenforced (for a detailed account of the dispute see Ursal 1999).

State auditors verify receipts against collection reports and trace them in the books of accounts. They are unable to verify whether revenues were properly assessed, collected in full, remitted in full, and accounted for in accordance with the pertaining laws and regulations. This leaves COA revenue audits virtually meaningless and opens up space for tax manipulations.

The BIR has been audited by resident COA auditors.<sup>159</sup> With auditors staying in their assigned office for three years, upon performance evaluation and request sometimes longer, and interacting with their 'office neighbours' on a daily basis, a frequently voiced concern has been that there is an imminent danger that audits lack in objectivity as personal relations between the auditor and those to be audited are established.

Even if the COA held the right for a full revenue audit and integrity of its auditors was guaranteed, the COA would have difficulties to fulfil its tasks: While details on staff assignments to the BIR are unknown, there are indications that they fall deplorably short. An interviewee indicated that there were ten state auditors at BIR headquarters and some more allocated to the Philippines' 19 revenue regions. Audits are compliance-rather than risk-based and focus too much on the identification of individual irregularities rather than on systematic issues. The COA does not hold prosecutorial powers; it can only communicate its findings and concerns.<sup>160</sup> Whether and if in how

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<sup>159</sup> This is a legacy of the time when salaries and allowances of state auditors were paid by the agency audited.

<sup>160</sup> Audit reports are published on the COA webpage. An analysis of audit reports between the years 1992 and 2007 shows, that the COA issued qualified opinions on BIR transactions only in 2001-2004, audits in all other years resulted in either adverse opinions or disclaimers (COA 2008 as quoted in HDN 2009: 33). From time to time audit reports delivered valuable hints, e.g. unliquidated cash advances and unreconciled balances.

far, COA's findings and related recommendations are followed up is unknown. The perception is that follow-up is weak.

The Office of the Ombudsman, next to the Civil Service Commission, is responsible for promoting integrity and enforcing discipline among government officers and employees. It has been perceived as inefficient. According to former Ombudsman Simeon V. Marcelo (2002-2005), the Office has been grossly understaffed and underfunded. In 2002, it had a staffing level of 1.000 employees, yet of these only 32 were full-time prosecutors. These handled about 2.500 cases. Only 37 employees worked as field-investigators. Specialised training programmes to improve employees' skills did not exist; surveillance and monitoring equipment was deficient; and internal record management and performance monitoring was not heard of (Marcelo 2003). Since, an increase of the budget, and of prosecutors and investigators plantilla have been approved; in addition international assistance has been flowing in (TAN 2009). The Ombudsman's conviction rate did rise and fall through the years; in how far is hard to say as rate calculations allegedly have been manipulated (PCIJ 06.-09.02.2011).

Marcelo's successor Merceditas Gutierrez, Arroyo ally, close friend and law school classmate of "Mike" Arroyo, was alleged of underperformance and inaction on high profile cases. Gutierrez was regarded as the most ineffectual Ombudsman since 1989. In 2009 and 2010, impeachment charges alleged that:

During the term of Ombudsman Gutierrez [2005-2011] the filing of a complaint on illegal acts involving the President Gloria Arroyo, the First Family, or top officials of her administration with the Office of the Ombudsman virtually carried with it a guarantee that the complaint will be forgotten, the perpetrators unpunished, and the taxpayers' money siphoned into their pockets will never be recovered (House of Representatives 2010: 6).

The first impeachment attempt was dismissed, but a subsequent impeachment attempt under President Aquino was approved with large majority at both the House of Representatives and the Senate. Yet, before the final verdict came down, Gutierrez announced her immediate resignation in May 2011 (GMAN 22.07.2010; ABS-CBN 04.07.2011). A huge case backlog awaited her successor: Conchita Carpio „Morales noted that in the central office alone, there were 11.000 pending criminal and administrative cases, some of them languishing there for years." (PDI 15.10.2011).

The Court of Tax Appeals is the country's only court handling tax cases. Until 2004, only one presiding judge and two associate judges, each holding a law degree and appointed by the president, decided tax cases of civil character. The potentially criminal side of tax disputes was not touched. Decisions were binding and no further appeals permitted. Judicial proceedings were long, costly, and burdensome, in particular if the taxpayer was not residing in the Metro Manila area. In 2000, with 228 new cases, a caseload of 566 cases, and a backlog of 410 cases, the CTA's backlog to caseload ratio was as high as 70% (Sicat 2007a: 60). It follows that settling disputes by negotiation has been cheaper both for the BIR and the taxpayers.

Under these circumstances tax reforms constitute a particular challenge.

## 5.4 Process of Reform

### 5.4.1 Domestic Actor Constellations

Support for tax administration reforms has come and gone, depending on particular individuals rather than groups, as well as the reformers' leeway among the contextual conditions and circumstances given by the particular political situation at a certain time.

When President Gloria Macapagal-Arroyo came to power in 2001, public expectations were high. Her being a trained economist, she had taught at two prestigious Philippine universities and worked on economic and social issues for the larger part of her career, it was believed that she would possess the technical and political skills to reform the economy and lead the country to prosperity. In her first State of the Nation Address she promised to "make the BIR and Customs showcases in this fight against graft and corruption", pledged to "control the budget deficit by collecting taxes vigorously and spending money prudently", and appealed to Congress to support overhauling the BIR (Macapagal-Arroyo 2001). Later she demanded tax evaders to be put into prison and asked for the passage of several revenue-enhancing laws (Macapagal-Arroyo 2002).

Arroyo's appointees to the economic team at large were competent, motivated, and inclined to change the status quo, yet more so in the earlier years than in the later years. The President tried to instruct reforms in the early years, but backed down the more she came under pressure during her presidency. With five secretaries of finance, five undersecretaries for revenue, operations, and legal affairs, and six commissioners of internal revenue, Gloria Arroyo might well enter Philippine history as the president with the most frequent reshuffles in the executive's tax-related economic team (Author's analysis based on data from BIR ARs and DOF ARs, each 2001-2010). While generally in support of tax reforms as a means to increase revenue collections, Arroyo's political will became increasingly elusive during her presidency. In mid-2010, Benigno Aquino took over the presidency. He pledged to increase tax revenues by tax administration reforms only; no new taxes would be introduced.

Exceptionally, the rotation of finance secretaries was more frequent during the first half of Arroyo's presidency than the second half. The individuals she chose had backgrounds in business administration, economics, law, and public administration, and were already quite experienced managers when they accepted the secretary of finance position. Alberto Romulo (01/01-06/01) had been a former Senator (87-98) and had served as majority leader for five-years; Jose Isidro Camacho (06/01-11/03) had gained reputation as an international investment banker before joining government in 2001 as the country's energy secretary; Juanita Amatong (12/03-02/05) was a finance career official serving in various functions at the Department of Finance, Central Bank, IMF, IFC, and the World Bank; Cesar Purisima (02/05-07/05) spent most his career life as a private sector auditor in the country's most reputable firms before joining government as the secretary of trade in early 2004; and Margarito Teves (07/05-06/10) the longest serving finance secretary under Arroyo prior to his appointment had been a member of the House of Representatives, where he had served as Chairman of the Economic

Affairs Committee and Vice-Chairman of the Ways and Means Committee (87-98), and been the CEO of Philippine Land Bank, one of the largest government-owned and controlled corporations (Data from PCIJ i-Site). With the exception of Romulo, who was appointed executive secretary<sup>161</sup>, and Teves, all incumbents resigned. Allegations abound that elites exerted influence, as the following stories illustrate.

"Lito" Camacho, who was regarded as credible and instrumental in bringing forward necessary public finance reforms, explained he had "physical, financial and emotional" reasons to resign. The position he occupied was exhausting like running "a 100 m dash competition with no finish line in sight" it was time to "pass the baton to the next runner" (MB 22.11.2003).<sup>162</sup> Palace insiders, however, claimed that he left due to a rift with the President who insisted to retain Winston Garcia, president and general manager of the Government Service Insurance System (GSIS), whom she had personally appointed in 2001, in his position, despite constant staff complaints of managerial ineptitude, oppressiveness, laxity, and public allegations of government pension funds mismanagement.<sup>163</sup> Others believed Camacho was under attack because of his support in the introduction of "lifestyle checks" on government officials, which pressured him to tender his resignation.<sup>164</sup> Gloria Arroyo flatly denied these claims (PS 26.11.2003). Yet, there are indications that Arroyo had been indebted to Garcia. Winston Garcia is member of an influential family from Cebu, which had formed an alliance with Arroyo. As admitted by a clan member, Arroyo supported the infrastructure development of Cebu and the Garcias supported Arroyo (PDI 15.05.2012). Among others, according to former Air Force General and Bureau of Customs Commissioner (1977-1986, 2000) Ramon Farolan, who is regarded as reform-oriented and integer, the Garcia family "provided the President with significant support during the 2004 elections" (PDI 14.09.2009). In Cebu, Arroyo, with a margin of over one million votes, won a landslide victory. But, nationwide, her winning margin was narrow; having won 12.9 million votes and her closest rival Fernando Poe Jr. winning 11.8 million votes. Allegations were made that the vote was rigged (Verzola 2004; PCIJ 28.-29.07.2004; PCIJ 2005). In subsequent years, Arroyo kept close relations to the province. She took her oath as the Philippines 14<sup>th</sup> President and opened a presidential residence in Cebu City. This, often dubbed as the Malacañang of the South, she frequently visited.

Juanita Amatong, who was officer-in-charge of the Secretary of Finance, had the reputation of a technocrat, who had strong technical skills, but did not feel at ease in politicking. According to a finance official "Amatong knows which policies are right or wrong. 'The problem is that she sometimes hesitates to act when she feels that she's

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<sup>161</sup> The executive secretary is the head of the Office of the President and serves as the highest ranking member of the cabinet.

<sup>162</sup> Following Camacho's resignation stock-markets reacted with the Peso slumping to a new record low since the political turmoil of the EDSA II revolution which introduced the ouster of President Estrada.

<sup>163</sup> In SWS's (2005) surveys on corruption, in 2003, the GSIS was perceived as the third most corrupt agency, right after the Department of Public Works and Highways and the BIR. In 2004, GSIS's reputation worsened, coming in second right after the Armed Forces Philippines, therewith overtaking the BIR. For a documentation of the contested issues see PCIJ (03-04.10.2001 and 30.03.2007).

<sup>164</sup> On lifestyle checks, see Chapter 5.4.4.

going against someone with more powerful backers” (N 18.11.2006). However, one of Amatong's main tasks as secretary of finance was to convince Congress of the worth of passing the government's revenue package. These included tax measures Arroyo herself referred to as a “pain package” but necessary for addressing the country's budget deficit. The eight bills proposed were geared at enhancing revenues through fiscal policy reforms, and reforming the tax administration by transforming it into a semi-autonomous revenue-agency (further discussed below). The large majority of politicians were opposed to these measures. Few deliberations made it to the floor, most never left the committee level; critiques claimed the bills were being watered down. Amidst frustrations that only one bill had been passed, and Philippine credit ratings were again downgraded, Amatong handed in her resignation. Amatong stated she decided to leave because she did not “like this high pressure job. ... the finance secretary is a high-profile job and my personality is not fit”. Rumours circulated that in fact it was rather a courtesy resignation, upon the instruction of the President; both Amatong and Arroyo denied. (PS 23.01.2005).

Finding a replacement for Amatong was not as easy as Arroyo had believed. According to Cesar Purisima, he only accepted the appointment after a long discussion with Arroyo, where she had to promise him a free hand in deciding who would become a member of his economic team and her unconditional support in “everything he would do as finance chief” (N 20.06.2005). One of his first decisions was to establish a Run After Tax Evaders (RATE) programme to complement the existing Revenue Integrity Protection Service (RIPS). He took active interest, supported the BIR with Department of Finance resources, made sure that a case was filed every week and the public was well informed. Further, to demonstrate political will, he personally followed up cases filed with the Department of Justice as well as the Court of Tax Appeals. The basic idea was to show Filipinos that his economic team meant business, and no longer accepted compromise agreements (see Chapter 5.3.3). In May 2005, Congress passed the E(xpanded)-VAT law, which was projected to significantly increase revenue collections and thus to have a significant impact on the reduction of the Philippines' fiscal deficit. Revenue collections increased visibly, until the Supreme Court issued a temporary restraining order. President Arroyo failed to react strongly. In July 2005, Purisima after only six months in service resigned as a member of the Hyatt 10, protesting the capture of prudent politics by irresponsible decision-making guided by the logic of Arroyo's struggle to survive (see Chapter 5.2.1). Purisima returned in 2010 as the Finance Minister of Benigno Aquino's cabinet. The confirmation of his appointment by the congressional Commission on Appointments had been deferred until mid-2011 as the Commission alleged discrepancies in Purisima's statements of assets and liabilities for the years 2006 to 2009 (PS 10.05.2011).

“Gary” Teves was Arroyo's last finance secretary; he stayed longer than all his predecessors taken together. This might have been influenced by his policy-making being less characterised by a high-degree of exhibited passion but restrained pragmatism. Teves supported reforms in general but tried not to be too confrontational.



By keeping a comparatively low profile, overseeing rather than pushing, and regularly meeting with tax officials and businessmen to discuss problems and likely solutions, he sustained. While balancing the budget proved difficult and meaningful reforms hard to achieve, Teves chose to focus on promoting economic growth. London-based magazine "The Banker", which is part of the Financial Times group, following a survey conducted among economists and bankers, named Teves "Finance Minister of the Year/Asia" (B 05.01.2009). Supposedly, he earned this award more for his prudent management of the effects of the global financial crisis on the Philippine economy, than on his achievements in reforming the revenue agencies.

Changes of the department of finance's undersecretary for revenue, operations and legal affairs, whose task included the support of reforms in the country's revenue agencies, followed a comparable pattern: Cornelio Gison (2000-2003) resigned, Grace Pulido Tan (2003-2005) resigned, Emmanuel Bonoan (2005-2006) resigned, Gaudencio Mendoza (2006-2008) resigned, only Estela Sales (2008-2010) stayed until being transferred by President Aquino to the BIR as its deputy commissioner for the legal and inspections group. While the majority cited a heavy workload and related health problems as reasons for their resignation, some made hints that indicated political reasons. These hints however so far were not confirmable.

The most vulnerable position in regard of tax administration reforms has been the commissioner of internal revenue's. During Arroyo's tenure, the Bureau of Internal Revenue has seen six commissioners, with an average tenure of 1.5 years: René Bañez (02/01-08/02), Guillermo Parayno, Jr. (08/02-07/05), Jose Mario Buñag (07/05 (ad interim) 10/06-06/07), Lilian Hefti (07/07-10/08), Sixto Esquivias IV (11/08-10/09), and Joel Tan-Torres (11/09-06/10). Similar to the other economic posts, either the incumbent was unwilling to stay long, or the incumbent was not encouraged to stay long. Again, elite influence seemed to have played a role.

Bañez, a tax lawyer, despite having been deputy commissioner of BIR's resource management group between 06/93-11/95, was considered an outsider having spent most of his career in the private sector. Appointed by Arroyo in 2001, he had the ambitious goal to transform the BIR into IRMA, the Internal Revenue Management Authority, a taxpayer-focused semi-autonomous revenue agency, which would be better isolated from elite influence and where tenure of tax officials would be performance based. Yet, he did not succeed. Bañez was pushed out by strong opposition in parliament and the BIR (further discussed below). As Arroyo pled in front of Congress

René has been threatened. He has been blocked by restraining orders at every turn. After the Supreme Court ruled in his favour, he was accused of the very corruption he is stamping out. This man needs friends, who share his goals, and I know he will find them in this young congress (Macapagal-Arroyo 2001).<sup>165</sup>

Explaining his resignation Bañez told a press conference

<sup>165</sup> Two civil and nine criminal cases were filed against Bañez, the first already after he had spent only four months in office. Except for one they were all dismissed by late 2004 (N 05.12.2004).

I strongly believe that a few perpetrators are out to sabotage the reforms by deliberately cutting back on collections during the first half of the year. They are undermining principles behind the reforms through a campaign to misinform the rest of the workforce. They are holding the country hostage in their desire to protect their own personal interests (FT 20.08.2002; PS 20.08.2002).

Later he added:

The difficulties of undertaking tax reform are abundant and serious. For one, the political pressures are so enormous they can paralyze the initiative. These pressures are both internal and external. Internal pressure is principally the resistance from revenue personnel who will be affected by the radical changes. External pressure comes from the allies of the same personnel, from within and without the government who are benefiting from the present setup, and taxpayers who will be affected drastically in terms of having to declare their correct income and pay the right taxes in the future. They want to destabilize the efforts and weaken the reform proponents (N 05.12.2004).

Bañez seemed to have lost his believe in winning what he called “a fight between good and evil” one year prior to his departure (FEER 05.07.2001). The President’s earlier proclaimed “full support” had faltered, as demonstrated by her immediate acceptance of Bañez’s proposal to resign (Macapagal-Arroyo 2001). The extreme pressure she cited as having caused Bañez to resign, probably has affected not only the commissioner but also herself.

Parayno, a former member of the Armed Forces, fiscal information technology specialist and psychologist, who had managed to implement reforms at the Bureau of Customs (1992-1998), took over the helmet. According to Arroyo, Parayno was “better equipped to reform the bureaucracy ... he is a seasoned campaigner ... has a very good intelligence network and very good people’s skills” (FEER 19.09.2002). Following a performance audit, Parayno reshuffled senior management and took individuals from the private sector on board. The number of deputy commissioners was enlarged to seven. During his tenure, Parayno focused on the computerization of the BIR, which he believed would eliminate loopholes in the tax system and thus make it more difficult for tax officials and taxpayers to engage in tax corruption. In anti-corruption programmes the Department of Finance and the Bureau of Internal Revenue shared a common goal: showing the public that, in BIR parlour, they meant business. Parayno resigned as member of the Hyatt 10. Undersecretary Bonoan and deputy commissioner Kim Jacinto-Henares, who were key figures in driving the BIR’s anti-corruption programmes and worked closely with Parayno, resigned only a few months later.

Parayno’s successor Jose Mario Buñag, who had been the deputy commissioner of the legal and inspection group under Parayno, following his boss’s sudden departure initially was appointed ad-interim. Yet, after one year his appointment was made ‘permanent’. A civil society representative interviewed claimed Buñag was appointed “to protect all those friends, vested interests, associated with the Arroyo family”, others reported that Buñag’s integrity was never questioned. Jose Buñag has been reported to have “been asked to submit his resignation after a meeting with the president. ... for failing to address widening collection shortfalls” (FT 21.06.2007). A move that had been openly suggested already one year earlier by Presidential Economic Adviser Rep. Joey Salceda, filing House Resolution No. 1239 questioning in particular the collection of April 2006. The author’s comparison of BIR’s long-term collection pattern, however,

shows that there was no shortfall in collections. The BIR might have failed its April collection target, but it consistently collected more revenues, in every month, than it had done in the previous year, remaining within the BIR's traditional pattern of collection. Hence, one might assume, that Buñag's alleged failure to collect might have been an alibi explanation.

Lilian Hefti followed; she had been a long-term career tax official. Prior to her appointment as the BIR's Commissioner she had served under her two predecessors as deputy commissioner of the operations group. After just a year in office, she resigned citing health reasons. Yet, many believed that the true reasons for her resignation have been her inability to reach the tax target and a related rift between her and the secretary of finance (MB 11.10.2008).

Sixto Esquivias IV, a lawyer and certified public accountant, took over. He was regarded as an insider, as he had spent more than twenty years working at the BIR serving in progressively more senior positions until reaching the position of the deputy commissioner of the legal and inspection group in 1998. In 2000, Esquivias had left to work as tax consultant for a private sector accounting firm he had set up (BIR 2008b). He came back in 2008 as the Commissioner of Internal Revenue, reportedly backed by Senate President Juan Ponce Enrile and Senator, then NEDA Director-General, Ralph Recto, for whom Esquivias had served as consultant on various tax reform bills (ABS-CBN 22.10.2008). Esquivias, following an (officially) performance-based reshuffle of BIR personnel, initiated *Oplan Kandado*, a padlocking programme for under-declaring taxpayers, revived anti-corruption programmes, and announced to reinforce BIR tax audits. Esquivias however barely sustained a year. In October 2009, he resigned, explaining his resignation with health reasons and him taking the full responsibility for the revenue shortfalls the BIR experienced. Few observers believed Esquivias's explanations; amidst the economic turmoil no one would have been able to meet the unrealistic revenue goal. Rather, many believed that his departure had been plotted.

Since May 2008, President Arroyo had ordered the installation of positions that potentially undermined the powers of the commissioner of internal revenue. Administrative Order 263 extended the function of the presidential adviser on revenue enhancement (PARE) to investigate cases in BIR's large taxpayers unit. The position of the PARE, with the rank of an undersecretary, had been invented with Memorandum Order 196 by Arroyo in 2004 to assist both revenue-collecting agencies to improve their collections. Yet, her appointee, Narciso "Jun" Santiago, Jr, a former Bureau of Customs' official, and husband of Senator Miriam Santiago, chair of the Senate Committee on Economic Affairs and Vice-Chair of the Committee on Finances, triggered doubts in Arroyo's benign intentions. Later, newspapers reported that Arroyo appointed Santiago BIR deputy commissioner in charge of large taxpayers; Malacañang was quick to deny these reports (MS 28.05.2009, 29.05.2009).

Two months afterwards, Arroyo invented another position, the office of the senior deputy commissioner in the Bureau of Internal Revenue. Effective immediately, Joel Tan-Torres was appointed to the BIR to support the commissioner, provide policies and

pursue programmes on a variety of aspects in the operation of the BIR and in directing revenue officers, and to “perform the function of the commissioner in the absence of said functionary” (EO 827). Supposedly, Tan-Torres was given the post, as he had been close to Efraim Genuino, the chairman of the Philippine Amusement and Gaming Corporation (Pagcor), a GOCC, and Edgar Manda, the head of Laguna Lake Development Authority, also a GOCC, who have been close allies of the President and her husband (ABS-CBN 10.11.2009; Tadem 2013: 113). According to newspaper reports, Arroyo, Genuino and Manda were considered the financial triumvirate of the Arroyo foundations, with Genuino serving as the finance officer and Manda as the errand boy. Moreover, in the 2004 elections, Pagcor funds allegedly were channelled to Arroyo’s campaign coffers, and Manda allegedly led a group that arranged grassroots-level support for Arroyo in Cebu province (N 11.02.2007).

Esquivias is said to have objected Santiago to get involved with the large taxpayers unit, which accounted for almost 60% of BIR collections at that time (BIR AR 2009: 11), and got scolded over that during a Senate budget hearing by Miriam Santiago. She alleged he intended to tap the large taxpayers unit “for his fund-raising campaign” in the upcoming elections (MBI 05.10.2009). Others suspected that Esquivias left due to “conflict with finance officials on sensitive issues like the proposed new scheme in the collection of excise tax from cigarette producers as well as the selection of field officials to head tax-rich regional and district offices in Metro Manila, free from political interference” (MB 03.11.2009). Others argued, that Esquivias did not have a choice but to resign as he found out that “the appointment papers of his temporary replacement, senior deputy commissioner Joel Tan-Torres, had already been signed” (ABS-CBN 10.11.2009). As common under these circumstances, all parties involved denied, claimed to have been clueless, and cited that no politics were involved.

Joel Tan-Torres, a certified public accountant, prior to his appointment as senior deputy commissioner of the BIR came from a private sector accounting firm, but he has not been a stranger to the BIR having worked there from 1980 to 1996, and having been engaged with it among others as the president of the Philippine Chamber of Commerce and Industry’s committee on taxation. During his period as commissioner of internal revenue he kept a relatively low profile.

In 2010, President Aquino appointed Kim Jacinto-Henares, who had supported him in his presidential campaign by giving advice on economic policy and reportedly is one of his shooting buddies, as the new CIR. While coming from the private sector, Henares already had some experience in the BIR as she had served as the deputy commissioner on special concerns under Parayno, and deputy commissioner in charge of large taxpayers under Buñag. Prior to her appointment she worked at the IFC/World Bank as senior private sector development specialist and task team leader of the National Program Support for Tax Administration Reform (NPSTAR). One of Henares’s first acts in office was to abolish both the positions of the presidential advisor on internal revenue and the senior deputy governor in the Bureau of Internal Revenue (MBI

02.07.2010).<sup>166</sup> As no information on the actual work of these two positions exists, it is impossible to gauge what kind of considerations and intentions have actually been behind these appointments. The reputation of Henares has been that of being clean, committed to reforms and tough on issues.

The frequent changes in personnel were partly caused by reform opposition. The impact has clearly been negative for reform advancement. Reform-oriented commissioners were not given enough time to learn, to implement, and safeguard innovations for sustainability. Tax officials were not given enough time to adopt meaningful changes. With every new commissioner, the emphasis changed, a number of old policies were no longer pursued and new policies were introduced.

Within BIR the support for reform has been uneven. Comparable to the perception of the shares of tax officials of integrity and of less integrity (see Chapter 5.3.4), the number of staunch supporters for tax administration reform is small, as is the number of staunch oppositional forces. The majority of tax officials can be swayed into one direction or the other. Yet, it appear to be in particular the opposition groups who have the stronger arguments and the more influential relations.

Philippine civil servants are well organised which helps to channel lobby activities. Based on the author's research, within the BIR at least seven employee associations, unions, and cooperatives exist: BIREA Bureau of Internal Revenue Employees Association, ACROPHIL Association of Chief Revenue Officers of the Philippines, PARDO Philippines Association of Revenue District Officers, BIRCELAS BIR-CPA-Lawyers Society, BIRREXEA BIR Retirees and Ex-Employees Associations, BIRSALA BIR Savings and Loan Association, and the BIR Multi-Purpose Cooperative. As noted by a finance official interviewed via these organisations, "... they [tax officials] can initiate actions altogether among the employees of the Bureau. They can stage protest; they have this trend to voice out what they want".

Particularly visible incidents of such concerted actions were the protests against Commissioner René Bañez in 2002. Bañez had reshuffled personnel, and intended to abolish the BIR to replace it with IRMA Internal Revenue Management Authority, a "public organization with corporate-like features". The IRMA was to be headed by a chief executive officer appointed by a seven-member Internal Revenue Board, and tax officials' tenure, placement and dismissal was to be strictly performance-focused, based on merit and fitness. (HB 5054, further discussed below). An idea unbearable for many tax officials, hence the subsequent months were characterised by tax officials rallying against the IRMA and Bañez. BIR employees filed charges against Bañez at the courts, appealed to legislators, run full-page newspaper advertisements blaming him "for the 'demoralization, antagonism, depravation, insecurity of tenure, injustice... that has taken

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<sup>166</sup> Around that time, rumours surfaced that Parayno was appointed undersecretary in charge of revenue generation; overseeing the operations of both the BIR and BOC (PDI 06.07.2010). Yet, in 2011, after alleged graft charges against Purisima, Parayno and BOC chief Alvarez had emerged, the Finance Secretary denied these rumours stating that "Mr. Parayno is not currently and never became an undersecretary of the department" (DOF 2011) By 2012, Parayno was perceived as supporting reforms.

root in the BIR”, staged rallies at the BIR compounds, displayed posters declaring “No to IRMA! We’re mourning the Death of the Bureau”, surged in and out of the BIR building as if they were storming it, and shouted for Bañez’s resignation. Only few days before Bañez resigned, several BIR employees received phone calls and text messages warning of a bomb explosion. It turned out to be a hoax (FEER 05.07.2001, 19.09.2002; PS 17.08.2002, 20.08.2002; Fabella/Chua 2011: 218-220).<sup>167</sup>

More disturbing, BIR employees sacrificed their duties of providing public service, protesting at the expense of the people they served, as criticised by Finance Secretary Camacho and CSC Chairman Constantino-David in a dialogue with BIR officials at the introduction of the interim BIR Commissioner Cornelio Gison at the tax authority’s national office (BIR 2002). What the two referred to has been the apparent revenue collection strike staged by BIR employees. “In 2001, there was a tax collection excess of 320 million over its target – the first since 1996. But in the first half of 2002, the shortfall was 35.5 billion pesos” (FEER 19.09.2002). Particularly visible is the strike upon analysis of the BIR’s monthly revenue collection statistics. While the annual pattern overall should be the same in every year, and with the exception of situations of severe economic and financial crisis absolute revenue collections should rise from year to year, in particular the collections in the months January, April, and July 2002 have been significantly below the respective collections of the previous year (Author’s analysis based on data from the Bureau of the Treasury).<sup>168</sup> Following Bañez’s departure, BIREA announced to support the introduction of the IRMA as a “welcoming gift” to incoming Commissioner Parayno (PS 30.08.2002), yet in fact the tax officials remained in opposition to any attempt of ‘corporatizing’ or ‘privatizing’ the tax authority. They believed that the move meant to punish them and continued to stage protests at BIR offices, the House of Representatives, and the Senate.

Among politicians, the implementation of tax administration reforms, which would make the BIR more efficient, despite their knowledge of the Philippines’ precarious fiscal situation, has not been a priority concern. As outlined earlier, in recent years more revenue-eroding measures were passed than revenue-generating. Similarly negative is the balance when measures directly touching the BIR’s set-up and operations are reviewed. Few comprehensive reform bills have been introduced for deliberation, even less made it to the floor, and very few were finally passed.

The most radical reform bill of the last decade filed has been House Bill 5054 of the Philippines’ 12<sup>th</sup> Congress (07/01-06/04) proposing “fundamental structural changes to tax administration in the Philippines” with the creation of the Internal Revenue Management Authority (IRMA).<sup>169</sup> It turned out to be too radical, hence other versions

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<sup>167</sup> Bomb hoaxes reach BIR offices nationwide every couple of years.

<sup>168</sup> A pattern comparably volatile since has not occurred anymore. Under the leadership of Esquivias, collections fell constantly below the collections of the previous year. This however might also have been related to the international finance market situation at that time (Author’s analysis).

<sup>169</sup> The bill was introduced by Representatives Jose C. de Venecia, Jr. (speaker), Julio A. Ledesma IV (NPC, Negros Occidental), Neptali Gonzales II (majority leader), Rolando Andaya, Jr. (Lakas, Camarines Sur), and Robert Ace Barbers (Lakas, Surigao del Norte).

amending HB 5054 were introduced, including HB 5546 proposing the creation of a National Internal Revenue Authority (NIRA), HBs 5465 and 6435 proposing the creation of a National Authority for Revenue Administration (NARA)<sup>170</sup>, and the corresponding Senate Bill 2463. Manasan (2003a: 185-191), comparing the main features of the house bills, found that the bills from version to version had been increasingly watered down. For instance, the legal provision in regard of personnel recruitment for the new semi-autonomous revenue agency had initially stated “no preferential treatment or priority right shall be given to or enjoyed by any personnel for appointment to any position”, it was then amended to “personnel at the bureau ... shall enjoy preferential absorption”, thereafter it was amended to allow for the “full absorption” (see respective HBs). Little information is available on the passage of the bills in the House of Representatives and in the Senate, yet what is sure is that none of the bills was passed.

According to the latest status reports available, in 2003 HB 5054 (IRMA) was pending in the Committee on Appropriations, in 2004 HB 6435 (NARA) was awaiting the Second Reading at the House of Representatives, and SB 2463 (NARA) pending in the Committees on Ways and Means, Government Reorganization and Finance (House of Representatives 2003: 15; 2004: 13). After the 12<sup>th</sup> Congress closed in June 2004, nothing was heard of the bills anymore (see House of Representatives 2005). More recently, bills suggesting the establishment of a Philippine Revenue Authority (PRA) and a National Revenue Authority (NRA) have been filed. They were either withdrawn or pending until they ‘died’ with the end of the respective Congress’s term. In light of such poor performance, the attentive observer will realise that the mottos chosen by Philippine Congresses, for instance “A Congress of Great Reform” (12<sup>th</sup> Congress 2001-2004), “Averting Crisis through Legislation” (13<sup>th</sup> Congress 2004-2007), and “Consolidating Reforms, Promoting Public Welfare” (14<sup>th</sup> Congress 2007-2010), are more the reflection of Philippine politicians’ popular rhetoric than a reflection of honest intentions.

Philippine senators and representatives are part of a complex web of well-entrenched vested interests, themselves being patrons, intermediates, and clients.<sup>171</sup> For instance, transactive relationships exist between individuals that politicians placed into the tax authority and between wealthy businessmen and politicians.<sup>172</sup> They have much to lose if a more effective tax authority would be introduced. Moreover, in societies at large any measure which potentially increases tax payments generally tends not to be very popular with constituents, putting politicians at risk of losing political support, a risk the majority would not want to take. Congress is an important marketplace with the majority of deliberations taking part in the committees and behind closed doors.

<sup>170</sup> The main proponents of NARA were Representatives Emmanuel Joel J. Villanueva (party-list CIBAC), Loretta Ann P. Rosales (party-list AKBAYAN), Florencio B. Abad (Lone-District, Batanes), Del R. de Guzman (Lone District, Marikina City), J.R. Nereus O. Acosta (First District, Bukidnon), and Ma. Theresa T. Defensor (Third District, Quezon City).

<sup>171</sup> Elected on a national mandate senators tend to be slightly more independent than representatives.

<sup>172</sup> Moreover, many legislators have personal business interests themselves.

Supposedly, lobbying involves regular and targeted payments from clients to patrons and patrons to clients, in exchange concessions are expected. The degree of interference and intervention varies from case to case according to the interests at stake and the bargaining powers involved. It is a given that regularly long-term public interests are sacrificed at the short-term benefit of the few. Yet, Philippine politics is too intransparent and too fluid, with ever shifting political divides and continual cases of partisan alignment and dealignment, to reliably assert what actions, which personalities, and which forces effectively were behind particular movements at a given time. It is only those that were directly involved, and generally would not like to talk, that can shed light on the issues.

Moreover, as became apparent in the discussion of pork barrel funds (see Chapter 5.2.1), Philippine politicians often do not behave in a way that would raise tax consciousness and encourage the voluntary payment of taxes. Walking around the country's cities and villages, anytime in the year, one might gain the impression that it is not taxpayers' money that has ultimately paid for public facilities but the local politicians' private money. Filipino politicians' faces and names are greeting passers-by from numerous banners and stickers affixed to buildings, bridges, and even wastebaskets: "Thank you ... for ...", "... a project of ...." A small note that taxpayers' money is involved has only recently been added upon the initiative of the BIR by some politicians.

Civil society in the Philippines is large and vibrant, yet only few carry out long-term research and advocacy work in the area of taxation and tax administration (see Dressel 2012: 72). Overall, their influence in this particular area seems to be small. In fact, it seems much smaller than in budget preparation and on the expenditure side of the budget. According to civil society representatives interviewed, they have tried to engage: Whenever they were asked for their opinion on a bill they appeared in Congress and gave their views, they have tried to disseminate information, and also to work directly with the revenue agencies. In the early 2000s, a civil society network called "*Huwag TaxSil*" undertook various activities. It tried to raise the tax consciousness of Filipinos, engaged in audit training of BIR officials, and monitored the performance of the BIR. However, most civil society organisations turned frustrated as they gained the impression that at Congress powerful individuals tended to win, and at the Bureau no one was really willing to engage. Hence, they gave up and chose to direct their resources rather to agencies and sectors where they believed they had bigger chances of achieving something. Asked why his organisation stopped engaging with the BIR, a civil society representative explained "Unfortunately we are in a position where we have to engage with agencies that show willingness to reform".

While the Philippine media has long enjoyed the reputation of being one of the world's freest press, and reports on corruption in general have been frequent, comprehensive reports on the Bureau of Internal Revenue have been comparatively sparse. The media, with the exception of investigative journalists supported with the financial assistance of international donors, paid little attention to in-depth discussions of tax issues. The BIR



itself staged press conferences and bought advertising space for public information campaigns. Many newspaper articles consist of the little to unamended publishing of BIR's official press releases. The timidity of journalists may have been related to the fact that most media are privately owned, the ability of wealthy individuals to buy the voice of some journalists, and a perceived danger to report due to multiple cases of libel suits against and a recent surge of extrajudicial killings and forced disappearances of critical journalists (Florentino-Hofileña 1998; PCIJ April-June 1999; Freedom House 2009b).<sup>173</sup> No widespread public debate on tax reform issues has developed.

Summing up, the analysis of domestic actor support indicated poor conditions for both taxation and tax reforms. There are serious impediments for the introduction of meaningful change. Leadership has been strong only for a short period of time. The more Arroyo felt her presidency in question, the more she responded to outside pressures and demands. The economic management team, in which many technocrats served, suffered from frequent turnover. Most sooner or later tendered their (courtesy) resignations; continuity could not develop. Only under President Aquino the situation has improved. For decades, the majority of politicians have not been in favour of reforms; so have tax officials blocked major reform attempts. Vested interests are strong. A public discourse on the legitimation and benefits of taxation so far has not developed; public pressure for reforms is low.

#### 5.4.2 Donor Influence

Engaging international donors has been an important pillar of the Philippine development strategy. According to the IMF's Independent Evaluation Office (2002: 144), "[t]he Philippines is probably the most extreme case of prolonged use of IMF resources, with 23 programs between 1962 and 2000." Various stand-by-arrangement and extended fund facilities have been in place over the last decades. Since the 1970s, tax administration reforms featured prominently in "virtually all IMF supported programmes" (IMF IEO 2002: 161, 163-165). In several cases, the introduction of tax reforms was made an implicit condition for credit disbursements. The last IMF arrangement expired in year 2000, with the parties involved already fearing that the Philippines had become over-dependent, before the final review had even been completed. A post-program monitoring programme was agreed upon. The International Monetary Fund has since persistently reminded the Philippines of the urgent need to improve internal revenue collections (see GOP/IMF 1998; Nakayama et al. 2012). Also for other international donor agencies, tax reforms have been a long-time favourite. Most donor agencies with a representation in the Philippines at a certain point in time were engaged in financial and/or technical assistance activities targeting the Bureau of Internal Revenue. However, so far, only limited results have been achieved.

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<sup>173</sup> According to the International Press Institute's Death Watch (2010), between 2000 and 2009, in the Philippines 94 journalists and media staff were "deliberately targeted because of their profession", making the Philippines the second deadliest country in the world. For comparison, in Indonesia within the same time frame only four journalists were killed.

The IMF (1998: 34f) criticised that too often powerful economic elites blocked or delayed reforms which had the potential to threaten their dominant position in the country. Relatedly, an unusually candid USAID evaluation report questioned whether “butting heads with the BIR and its network of vested interests after all of USAID’s experience in this area may be the ultimate waste of time” (Nathan Associates 2000: 20f). The perception has been that the Philippine authorities lacked ownership and strong commitment. They reacted on their development partners’ recommendations, without any clear idea of what they themselves wanted to do. According to an international organisation representative interviewed, “They [the BIR] know that there is something wrong, but they not really have a desire to know what is wrong with them”. The BIR has adopted a large variety of ideas mentioned and performance targets suggested by donor agencies, without real consideration of whether they would fit together, were feasible and meaningful. What counted for the Philippine authorities appeared to be foremost the securing of funds. Tax administration reforms are too important to neglect and too unpopular to vigorously pursue. Without donor influence and amidst soaring fiscal pressures probably tax administration reforms, while recognised, would not have made it on the country’s agenda. For the BIR and its “partners”, tax administration reforms largely have been a fiddling around exercise.

International organisations and donors were aware of numerous shortcomings and weaknesses slowing down their activities. Yet, most donors were not willing to take serious consequences and cancel contracts. What counted, most definitely for some donors, was the disbursement of funds. One of the few exceptions was German Technical Cooperation which had technically assisted the BIR in human resource development and management from 10/95 until 06/02 and decided to back out due to unsatisfactory project results. Most donors continued to engage with the BIR. Within the last decade the Department of Finance and the Bureau of Internal Revenue have availed themselves at least of the support provided by eight development partner agencies. The IMF, World Bank, and the United States took major roles.

The IMF conducted regular fiscal affairs missions, set-up a trust-fund mainly for the “Strengthening of Revenue Administration and Collection Efficiency” (2006-2009), and assigned technical advisors to the Department of Finance and the Bureau of Internal Revenue. A final report evaluating the outcomes of trust-fund activities is not publicly available. However, there are hints that the programme has not progressed as expected. Towards the end of the programme, significant amounts of the trust-fund have not been requested for expenditure, indicating problems at the BIR to implement reforms.

Upon the Philippine government’s request for assistance and following an IMF/World Bank diagnostic mission, the World Bank approved a complementing loan entitled the “National Program Support for Tax Administration Reform” (NPSTAR) to run from 2007 until end-2011. In December 2011, the loan was extended until June 2013 as a significant amount of funds had not been disbursed and certain conditions for extension had been met. The international finance institutions perceived the political environment

with President Aquino more supportive to reforms (World Bank 2011b: 13). Worries about substantial implementation risks however remained.

Consisting of four components, that is tax compliance, 32% of the programme costs; tax enforcement and control, 16%; human resource development and management, 21%; BIR management, change management and programme management, 31%, the loan's development objectives defined were "to increase taxpayer compliance by increasing the efficiency and effectiveness of the BIR, and to prepare the BIR for a sustainable and long-term reform" (World Bank 2007b: 2, 41). Activities supported by four development partners, more than doubling the available funds, complemented the NPSTAR. According to the World Bank (2007: 36), of the "estimated total reform cost by development partners" of US\$ 24.08 million, the World Bank contributed 46%, the United States Millennium Challenge Corporation (MCC)<sup>174</sup> 39%, Swedish International Development Agency (SIDA) 10%, United States Agency for International Development (USAID) 3%, and the Australian Agency for International Development 2.5%. The technical assistance component was large; each year about twenty international short-term advisors provided services to the BIR.

The United States ever since has been among the Philippines' major donors. The main motives behind this engagement have been its colonial past and the Philippines' geopolitical location and strategic role US governments perceived since World War II. Until 1992, the largest US overseas military installations were based in the Philippines, Clark Air Base and Subic Bay Naval Base (Lum 2012). Filipinos believe that US influence has remained strong. Already prior to NPSTAR, the United States provided financial and technical assistance to the tax agency via various projects and activities: AGILE Accelerating Growth, Investment, and Liberalization with Equity; EMERGE Economic Modernisation through Efficient Reforms and Governance Enhancement; EPRA Economic Policy Reform Activity; and LINC-EG Local Implementation of National Competitiveness for Economic Growth (USAID Philippines 2009). USAID has funded technical background reports on various stages of the taxation cycle, outlining weaknesses and suggesting options for improvement.

Since 2006, support via the Millennium Challenge Account-Philippines Threshold Program (MCA-PTP) technical assistance project has focused on "reducing corruption, improving revenue compliance and enforcement". Next to the BIR, this project involved also the Department of Finance and the Office of the Ombudsman. MCA-PTP has been particularly engaged in the flagship programmes Run After Tax Evaders (RATE) and the Revenue Integrity Protection Service (RIPS). A large share of funds was targeted for upgrading, and where necessary establishing, the BIR's computer systems. In addition, USAID provided investigation and surveillance equipment, and conducted related

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<sup>174</sup> The MCC is a government-owned independent corporation established by the U.S. Congress in 2004, in reaction to the 2002 Monterrey Commitment. Its declared mission is to build human and institutional capacity to promote sustainable economic growth and reduce poverty. According to the MCC, to profit from MCC grants countries have to fulfil certain eligibility criteria in relation to "good policy performance" and "have demonstrated reform commitment" (MCC 2008). In this regard the MCC's project selection in the Philippines has been somehow unclear.

trainings for DOF and BIR staff to improve the quality of evidence for pursuing RATE and RIPS cases (MCA-PTP 2009a; 2009b).

Anti-corruption programmes are important. Yet, only when individuals perceive the potential risks of deviating behaviour higher than the potential benefits, the programmes are likely to have a meaningful effect. RATE's and RIPS's performance indicators however focused on quantity, that is the sheer number of cases filed, rather than quality, that is the characteristics of cases filed and their outcome. Moreover, the achievement of these indicators was made a prerequisite for further support. It is questionable whether such quantitative indicators provided the 'right' incentives for the Bureau of Internal Revenue and the Department of Finance (see Chapter 5.4.4).

MCC Philippines, DOF, and BIR achieved their goals, while the decision for extension was actually delayed until after the national elections, the inauguration of the new president and the appointment of the economic team. In September 2010, the MCC's board of directors approved another five-year grant, including a US\$ 54.3 million Revenue Administration Reform Project (RARP). The project intends to further computerise the BIR's business processes, with a focus on taxpayer data management and automated auditing, to further support the RATE and the RIPS programmes, to undertake a public awareness campaign, and to provide the funds for an IMF resident advisor and several short-term advisors. By early 2012, physical equipments were delivered, preparations for preliminary terms of reference and strategic plans about to be finalised, and preparatory activities for several project components initiated (Millennium Challenge Account 2012). At the time of writing, the implementation stage within all activities proposed was still to be reached, whether this would ever be achieved was still too early to tell. With the new leadership of President Aquino, Finance Minister Purisima, and BIR Commissioner Jacinto-Henares, the MCC declared to be optimistic.

Sweden's grant entitled "cooperation in the field of tax policy and tax related statistics", with technical assistance running from 2007 until 2009, and funding until 2010, focused on capacity building activities in the fields of data and information generation, monitoring and analysis. The Swedish Tax Agency and Statistics Sweden were engaged as cooperation partners, seconding advisors and consultants to the Philippines, and welcoming study visit groups from the Philippines. The primary goal was to enable the BIR to base its strategic decisions, in particular in the field of tax audits, on reliable data and facts generated automatically from the BIR computer systems (Statistics Sweden 2007; SIDA 2010).

Australia, a major bilateral donor to the Philippines, has focused its development assistance on sub-national social development issues. Only as a minor component AusAID has been engaged in strengthening the Philippines' revenue agencies. AusAID provided technical assistance in the areas of human resource development and management. It offered trainings and intellectual exchange between Philippine and Australian practitioners and scholars. For instance, several tax officials from the Australian Taxation Office were short-term assigned to the BIR to compare the

Philippine tax system with their own, engage with Philippine tax officials, and provide trainings on various issues.

The Asian Development Bank's role has been minor. Financed partly by AusAID and the Japan International Cooperation Agency (JICA), the ADB engaged via its Development Policy Support Program loans (DPSP-1 and -2), participated in the government-donor group on tax reform, and carried out an analysis on perceived tax-related prosecution impediments under its project "Enhancing Revenue Collection and Strengthening the Criminal Prosecution of Tax Evasion Cases" (ADB 2007; 2010). Other one-time activities were carried out by the Canadian International Development Agency (CIDA) via its Policy, Training, and Technical Assistance Facility, and several neighbour countries. The number of implementing agencies is unknown; they include the local branches of major international consulting firms and local establishments. Their focus of work has been on ICT development and change management activities.

At the time of research, donor agencies remained comparatively silent on project status reports and achievements. Only little information has been publicly available, completion and evaluation reports were scarce. In case a project was not extended, no information was given on the specific reasons that led to this decision. The Philippine government often delayed or disallowed the release of reports. Hence, it can only be speculated that progress so far has been below expectations at best.

The analysis of donor cooperation in the Philippines pointed out that much of the country's tax reform efforts have been pushed for by the international community. Donor coordination, if at all, has been informal. Overall, Philippine ownership has been weak. The Philippines has had many opportunities with a large number of donors willing to engage, yet it has been unable to make full use of these opportunities. In regard of chances for successful reforms the picture presented is ambivalent.

The following chapters investigate how the BIR has made use of its opportunities and dealt with the stumbling stones.

### **5.4.3 Change Management**

#### *Internal Change Management*

The BIR has chosen a top-down approach. The top defined the reform priorities, while the definition of the top has been variable meaning the president, the secretary of finance, or the commissioner of internal revenue. Subordinate levels of authority devised related programmes; these then were cascaded down.

According to Commissioner Bañez, BIR management had a communication strategy addressing various issues related to the introduction of a semi-autonomous revenue agency. Yet, tax officials criticised that they were not properly informed about the plans discussed, hence misunderstandings between the management and staff led to severe frustrations. As described earlier, the reform attempt was blocked by reform-opposing BIR staff, delayed and subsequently not further pursued by Congress. The inadequacy of internal change management proved a stumbling stone.

Several interviewees explained that in subsequent years the BIR paid more attention to internal communication and towards motivating tax officials to align themselves with modernisation and reform. In 2006, the BIR established a Tax Reform Administration Group (TRAG) under the guidance of a deputy-commissioner 'in excess' at national office to meet donor requirements. In essence, the TRAG was a temporary add-on to the BIR organisation, and not an office of equal status to those offices that had existed. Entrusted with the responsibility for the administration, coordination and management of reform activities, the TRAG's tasks included the coordination and facilitation of reform planning and implementation, liaison with internal and external stakeholders, as well as the implementation of change management activities.

The TRAG had an official plantilla of 30 to 50 staff members, but it was never able to fill these positions. According to various resource persons, the TRAG had a staffing of five to ten people only in 2009. The severity of the office's personnel situation is illustrated by the following comment of a tax official interviewed:

We cannot encourage people or personnel to join that group on a full-time basis. ... Before there were thirteen and then they started leaving, transferring, because they are now discouraged in continuously doing the job, because of some changes in the administration. ... I do not know what kind of incentive we would give them, so that they would stay on a more or less permanent basis throughout the duration of the project.

The situation of the TRAG indicates that tax administration reforms were not taken seriously. The TRAG had been side-lined. Tax officials regarded it as the BIR's backwaters. Thus they feared that TRAG placement would put their career at danger. Between the years 2007 and 2009, a crucial period to get reforms going, three different deputy commissioners have been in charge of the tax reform administration group, Lucita Rodriguez (07/06-08/08), Danilo Duncano (09/08-03/09), and Marietta Lorenzo (since 04/09). The impact on reforms probably has been negative. Apart from the disruption of continuity, it was Duncano's tenure which was particularly questioned. Supposed to lead reforms, he himself came under investigation for unexplainable assets (see Chapter 5.4.4). Whether Duncano was appointed as indeed a reform-oriented personality or had been put on a holding place remains unanswered. If the latter is true, as also commented by an international organisation representative interviewed, "That does not speak well of a bureau that is trying to go through a reform process". If the first is true, that does not speak well of the reform-willingness of BIR's environment.

The TRAG organised strategy and planning workshops at national office and conducted change management sessions at regional offices nationwide. A first outcome in 2008 had been the formulation of a reform agenda with nine priority actions and thirty task forces. According to the agenda, BIR has intended to enhance registration, filing and payment systems; enhance audit capabilities; improve collection enforcement and arrears management; strengthen legal and enforcement capabilities and enhance internal affairs management; strengthen taxpayer service development and compliance; improve the organization and performance management system; pursue a human resource development programme; roll-out computerization and other e-services nationwide; and manage the tax reforms. The TRAG assigned between two and seven task-forces to

each priority action (BIR 2008a). According to the Commission on Audit (AR 2009: 141), however, less than a third of task forces were either fully or partially implemented, while the remainder were not implemented at all. The task forces' heads were recruited on an ad-hoc basis among senior level tax officials.

Evidently, the BIR's reform agenda has been extremely broad. It covered all sorts of activities. A focus or a general picture explaining how the pieces of the puzzle do fit together has been missing. Again, one gains the impression that the BIR lacked desire and ownership, but rather was lured by the donor community's offers. Numerous advisors and consultants had presented a wealth of ideas and recommendations on what would be worth pursuing to the NEDA, the Department of Finance and the Bureau of Internal Revenue. Instead of seriously considering themselves what would be feasible and what would be the best options for them, the BIR's presented agenda appears to have taken up all sorts of ideas. It needs to be doubted that there was any outright decline of certain activities. While the agenda might look good on paper, one needs to worry that amidst such an array of projects it would be very difficult for BIR staff to reach effective reforms in any of the envisaged project areas. Moreover, as the task-force heads conducted their tax administration reform related tasks on a part-time basis only, that is in addition to their regular work, the incentive to invest a lot of time and energy was small. Engaging in tax reforms either meant working far more than was expected or reducing ones activities in the mother office.

Therefore, rather than really being involved, the large majority of tax officials, in particular those in the regions, were recipients of information only. Information was disseminated in writing and via personal visits of management staff to regional and local tax offices. Yet, it was not ensured that everybody received the information, and that the complete information was accessible afterwards. Anti-corruption trainings related to the PAGC and BIR Integrity Development Action Plan in 2009, as disclosed by the COA (AR 2009: 141), for example were conducted in Luzon BIR offices only. Seventy percent of funds received for that activity were not spent and returned.

To internalise the proclaimed reform spirit, the BIR's vision and mission statements, and even more often the related organisational values and goals were repeated by its staff members at various different occasions, at times also in presence of the secretary of finance. For instance, during the weekly mandatory flag-rising ceremonies and other official events tax officials were invited to take public oaths, pledge allegiance, and read out aloud their personal commitments to their peers. Sometimes, religiously inspired symbols, like the lighting of candles, were used to underline the message to be taken forward.

Only under President Aquino and Commissioner Henares, reform management became more organized. In 2011, the BIR institutionalized a Project Management and Implementation Service (PMIS) to develop medium-term strategy plans, manage and oversee reform projects and activities. At the time of research, PMIS was divided into a project development and management division, and a project monitoring and evaluation division. Staff of the former TRAG was largely retained; in addition some new staff

members were attracted. PMIS staff worked on a full-time basis. In addition, the Reform Steering Committee was reconstituted and manned with members of the management committee and selected regional directors to provide policy suggestions and resolve high level issues pertaining to reform activities. External stakeholders were invited when needed. Meetings took place infrequently. A “think tank” of selected tax experts further advised the PMIS on various tax administration and change management issues. The reform management team, though still small, was stronger and enjoyed more high level support than ever. Donors expressed optimism with the new leadership.

#### *Rewards over punishments*

Next to information sharing, the BIR introduced a combination of reward and punishment policies to guide tax officials towards fulfilling the proclaimed values and goals. Despite punishment policies, foremost the “Lifestyle Checks” and the “Revenue Integrity Protection Service” programmes, largely given centre-stage in BIR reform activities (see Chapter 5.4.4), in practise it have been the ‘rewards’ that prevailed. So-called sanctions were hardly meaningful or not implemented at all.

A case in point has been the implementation of the “Lateral Attrition Act” which Congress had passed in January 2005.<sup>175</sup> The stated aim of introducing lateral attrition to the revenue collecting agencies, BIR and BOC, had been to improve their collection performance by encouraging revenue officials to exceed their assigned revenue goals and curb corruption through a system of rewards and punishments. Revenue officials exceeding their targets were promised monetary and non-monetary rewards such as the transfer to popular positions and promotions, while revenue officials falling short of their targets by at least 7.5% with “due consideration of all relevant factors” were threatened with their dismissal from service, simply underperforming officials would be transferred to lower-ranking offices and/or demoted.

For the implementation of the lateral attrition act, rewards and incentive funds sourced from excess collections and a revenue performance evaluation board were established.<sup>176</sup> Implementing rules and regulations were approved by mid-2006.<sup>177</sup> Further, a performance management system was developed with USAID assistance. The responsible consultant however noted that his counterparts

... were very laidback in the installation of PMS in the Bureau. They may have been distracted by the pressure of meeting the Bureau's revenue target. The lack of enthusiasm about the PMS could also be due to its association with the lateral attrition law, which in first place, has not been

<sup>175</sup> Before Republic Act 9335 was passed, several different bills had circulated in the House and the Senate. These were left pending and vetoed for at least four years.

<sup>176</sup> The revenue performance evaluation board is composed of the secretary of finance, the NEDA director-general, and as non-voting members the revenue agencies' commissioners, two elected lower- and middle level employee representatives and one senior level employee representative each.

<sup>177</sup> If the annual collection target is exceeded by up to 30%, 15% of the excess accrues to the fund. In case the board decides that the reward is warranted, the money is distributed within the agency's departments and offices “in proportion to their relative contribution to the aggregate amount of the excess collections over the target” (RA 9335). Effectively, this means that officials with a higher salary grade are likely to get larger shares.



consistently moved forward by the DOF-led Revenue Performance Evaluation Board (CARANA Corp/Nathan Associates Inc. 2007: 26f).

The lateral attrition act has remained highly controversial and contested among its national and international stakeholders. Congress members urged for a review, employee representatives questioned its constitutionality, and international financial institutions called for its repeal. Critiques argued that the lateral attrition act is an inappropriate and ineffective tool to improve the performance of the Philippine revenue agencies. Reasons leading to this argumentation are plentiful: First, concentrating on revenue collection only is not a good practise, as it is not only important how much is collected, but also in what manner it is collected. It should be considered, whether taxes are collected equally or the honest taxpayers are squeezed to reach tax targets while the rich are simply let go. Second, by the time of research the Philippines did not have the data, information and the tools necessary to predict reasonable collection goals. Third, it is highly questionable whether the right incentives have been set; the act's provisions offer a series of loopholes that can be used for omission and manipulation.

It is thus hardly surprising that even seven years after Congress had passed the law, it was not yet implemented to its full extent (BM 26.02.2012). While the BIR persistently (see Chapter 5.3.3) and the BOC most of the times fell short of collection targets, not even a single revenue official has been dismissed. It was even only in 2008 when the finance secretary for the first time ever asked the commissioners for a list of underperforming revenue officials. These cases were discussed by the revenue performance evaluation board, but explanations on the grounds of the shortfalls drawing on various conditions outside of the suspected individuals' own sphere of influence were accepted by the evaluation board and the oversight committee in every single case.

The first and so far only time the provisions of the lateral attrition act were applied was to reward BOC officials for exceeding their 2006 collection target. A bonus of more than P 500 million was awarded and distributed among the BOC's staff members. Commissioner Napoleon Morales, who is said to have been close to the president's husband "Mike" Arroyo, who allegedly had been involved in smuggling, alone received about P 5 million in rewards. The decision however was publicly questioned, not only as the BOC was formally opposing the lateral attrition act by asking the Supreme Court for a temporary restraining order, but also as the BOC was alleged of having met its target only by collecting advance payments from oil companies. Allegations the BOC refuted (GMAN 03.03.2008; PS 02.07.2008, 26.09.2008). As the BIR since the introduction of the lateral attrition act has never met its revenue target, it remains unknown whether such conflicting and contradictory behaviour would have occurred also at the tax authority.

On the other hand, the exemption of the BIR from the Salary Standardization Law and a related pay raise, despite several House and Senate bills introduced and various commissioners in favour of such a measure, so far has not been passed by Congress. Under various commissioners however tax officials were granted a diversity of other explicit incentives "to uplift the morale of Bureau personnel" (RMO No. 28-2004), "to

help revenueurs to cope with the rigours of government service” (BIR 2004a: 4) and “with stress in the workplace” (BIR 2009a: 4). Regularly, model employees were honoured with different personal and office awards, which included certificates of appreciation or recognition, trophies, emblems and pins, salary step increments, productivity incentives, career- and self-development incentives, as well as other incentives as seen fit. Selection criteria have been vague however. Thus, there is no guarantee that the initial intentions of a well-appreciated staff motivation strategy have not been distorted. Vagueness and discretion, as has been described earlier with regard to Philippine tax policies, allow particularistic decision-making in favour of the elite.

More encompassing have been the “employee welfare” and “people wellness” programmes carried out at the Bureau of Internal Revenue with varying intensities under different commissioners. In 2005, Commissioner Parayno for instance introduced physical fitness sessions, including aerobics, belly dancing and Tae-Bo, taking place at the BIR auditorium every Tuesdays and Thursdays from 3:45pm until 4:45pm. Fridays also from 3:45pm to 4:45pm stress management and livelihood project workshops were offered. BIR staff was given the chance to learn how to debone milkfish, make dresses and soap, craft souvenir boxes, and put on make-up (BIR 2004a: 4). Under Buñag these programmes were continued, while his successors initially trimmed it back.

Yet, when Commissioner Tan-Torres came in, one of his first acts following his appointment was to write an open letter to his staff reintroducing people wellness activities he described as the “foremost of the positive change revenueurs can expect in the coming days”. Apart from regular *hataw* fitness exercises Mondays, Wednesdays and Fridays, free clinics and sports fests, BIR staff could participate in crafts workshops, enjoy 15 minute massage sessions, bingo socials, karaoke nights, ballroom and disco dancing, watch movies, cook with the stars, and compete in beauty contests. Further Tan-Torres promised to revive the swimming pool at the BIR premises (BIR 2009b). Symbolically underlining how valued the BIR officials are, the 2010 Strategy Map, then “consisting of three (3) Priority Areas, sixteen (16) Programs, one-hundred eight (108) Activities and Projects, and ten (10) Strategies” placed “people improvement” and “people wellness” right at the top of the table and virtually alone on the Revenue Memorandum Circular’s first page (RMC No. 10-2010).

Participating tax officials certainly enjoyed these activities and were kept happy, yet whether these activities indeed had a stimulating effect on staff productivity, as was envisaged, from an objective standpoint remains questionable. The organisation of activities has bound valuable human and financial resources. Moreover, the majority of activities were offered during office opening hours and not after-hours or at weekends. This implies that either only few part-time staff members did have the chance to participate, or tax officials participating had to neglect their primary work activities. At best, such incentives have kept BIR staff motivated and cooperating.

Under Commissioner Kim Jacinto-Henares, BIR’s reform strategy and its related change management were strengthened. More focus, more consequence and more continuity were introduced.

### *External change management*

“The culture of paying tax is not that strongly implanted in the consciousness of our society” tax officials alleged. Hence, in communicating with externals the BIR declared to have three main intentions: educating taxpayers on the meaning of taxes, demonstrating BIR’s reform efforts, and convincing taxpayers to pay their taxes voluntarily and honestly. The BIR’s external change management strategies have been as diverse, inconsistent, and lacking continuity as the internal change management strategies described above. The strategic focus has been constantly shifting between taxpayer education, taxpayer service, and taxpayer threatening. Numerous initiatives have been started, yet most phased out soon. The Philippine saying ‘*ningas cogon*’ [cogon fire] illustrates the situation well. New initiatives were started with a lot of enthusiasm, yet the initial interest died down rapidly. A logic structure and a clear pattern were missing.

Foremost, the BIR has been active between end-February and mid-April every year, the last weeks before the annual income tax return filing deadline. Tax officials literally swarmed out to public places with car parades, booths at shopping centres and malls, balloons, corporate-colour t-shirts, tarpaulins, banners, and give-aways for distribution. The intention has been two-fold, educate taxpayers on taxes, what they are and what they are for, and to remind them of the approaching deadline. With a new campaign theme, slogan, and logo every year, however the recognition value has not been optimal. Analysing these annual tax campaign drives an impression one gains is that the BIR emphasises the promotion of voluntary compliance over enforcement operations. This is an internationally favoured strategy in long-term perspective, yet a strategy which in environments hostile to taxation is insufficient to achieve an increase in tax collections. Comparing the various campaign slogans and logos from the year 2003 until 2012, one message stands out: the declared central importance of taxes for building the Philippine state.<sup>178</sup> Appeals have been made to both tax officials and taxpayers. In its campaign logos, the BIR has been depicted as “a beacon of light ... the medium that keeps the light of governance burning” (2004), taxes have been described as the lifeblood of the nation (2006), and taxpayers depicted as an indispensable building block in bringing the nation forward (2011). The colour scheme used for most logos repeated the colours of the Philippine national flag, royal blue, scarlet red, golden yellow and white, underlining the message of the link between the BIR and the Republic of the Philippines. Along similar lines, Commissioner Parayno once appealed “I encourage all

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<sup>178</sup> BIR annual tax campaign themes for the years 2003: *Buwis Ko Alay Ko, Para Sa Isang Matatag na Republika* (I offer my taxes for a strong republic), 2004: *Buwis Sandigan Ng Republika* (Taxes are the foundation of the republic), 2005: unknown, 2006: *Buwis Ko Buhay Mo* (My tax is your life), 2007: *Makibahagi Sa Kaunlaran Tamang Buwis Ay Bayaran* (Share in the progress, pay your correct taxes), 2008: *Buwis Mong Babayaran, Ating Kinabukasan* (The tax you pay today is our tomorrow), *Itaguyod Ang Bayan, Tamang Buwis Bayaran* (Stand up for your country, pay your correct taxes), 2009: *Buwis Para Sa Bayan, Laan Sa Buhay at Kinabukasan* (Our tax is for the country, life, and our future), 2010: Making the Public Know, 2011: *Buwis Para Sa Bagong Pilipinas* (Taxes for a new Philippines), and 2012: I Love Philippines, I Pay Taxes (Author’s collection from various BIR sources).

of you to do your patriotic share in making your taxes the vehicle through which we can ensure a life of peace, progress and prosperity for our loved ones, and for every Filipino" (BIR 2003: 2). President Aquino and Commissioner Henares spread the message that taxes are an undeniable and inevitable part of life, alluding to Benjamin Franklin's famous statement that "In this world nothing can be said to be certain, except death and taxes".

Partly upon BIR's own initiative, but more often to comply with national legislation, e.g. RA No. 6713 "Code of Conduct and Ethical Standards for Public Officials and Employees" and RA No. 9485 "Anti-Red Tape Act of 2007", the BIR published documents and set-up initiatives supposed to inform the public, provide "fast, efficient, convenient, reliable service" and most importantly instil trust. The BIR's Code of Conduct, first drafted in 1989, had been amended several times. A Citizen's Charter outlining the process flows of the eight most frequent frontline services, the time needed and the costs involved, was drafted. Public assistance and complaints desks were set-up at local tax offices. Further, the BIR operates a Contact Centre to answer inquiries and receive feedback from its stakeholders, has accepted to participate in a national 24/7 citizen's contact centre project, and in 2009 and 2010 revived the early 1990s' *Handang Maglingkod Program* (HMP, literally: Willing to Serve), which opened competition among revenue district offices on who provides taxpayers' the best frontline services.

Another project carried out for a comparatively long-time, directly addressing taxpayers, has been the *Premyo Sa Resibo (PSR)* raffle promo in support of the BIR's "Ask for a receipt" campaign, which has been continuously in operation, albeit under various names, for a period of more than ten year already by 2013. The PSR aims to motivate taxpayers to always ask for official receipts from shops, enterprises, and service providers, and encourage these to issue receipts. For every P 100 taxpayers are encouraged to send a text message (SMS), alternatively join via Facebook or Twitter, at the cost of P 1.50 later increased to P 2.50, detailing the vendors tax identification number, receipt number, and receipt amount, to the PSR/BIR gaming system. These SMS serve as entries to participate in instant gaming and regular televised national raffle draws where cash prizes between P 5.000 and P 1 million can be won. According to PhilWeb Corporation (2012: 7, 28f), the PSR's hosting internet company, between 2006 and 2011, more than 180 million text entries were processed and a total of P 175 million in prizes awarded. As of late 2011, the PSR had a total of 1.5 million users, 6.000 Facebook fans, and 1.000 Twitter followers. Unfortunately it is unknown how many users are heavy users, and who participated once only. Nevertheless, we can assume that attention has been raised. Moreover, PSR might have helped the BIR to gain data that can be used to track delinquent service providers. However, there is no proof that receipts carried the real values and amounts, nor is it likely that the BIR was able to fully use the information received for data mining purposes.

Celebrities have played an important role in the BIR's public relations campaigns. Predominantly, showbiz personalities, such as actors, television hosts, singers and athletes featured as BIR endorsers, the country's top taxpayers, and the country's

persecuted tax evaders. The logic behind is that taxpayers can relate to these individuals. The grounds on which certain individuals are picked out by the BIR are unknown. The critical mind might wonder, whether and if in how far there is political motivation behind prominent cases?

A case in point presents the Philippines' highly popular, first eight-division world champion boxer and member of parliament since 2010, Manny Pacquiao ("the PacMan"), who repeatedly ranked among the world's most influential and highest-paid athletes (F 17.06.2009).<sup>179</sup> In 2009, Commissioner Esquivias convinced Manny Pacquiao, who had featured in advertising campaigns of many of the country's largest brands, to endorse the BIR and promote tax paying. Pacquiao personally went to BIR headquarters to file his 2008 income tax return three months in advance and shot a 30-second TV commercial with the secretary of finance and the commissioner of internal revenue to urge his fellow citizens to file tax returns in time and pay taxes (PDI 24.03.2009). According to BIR statistics, with P 125 million in taxes paid Pacquiao became 2008's top individual taxpayer. Yet, in subsequent years he slid being listed 113<sup>th</sup> paying P 7.4 million in 2009, and 135<sup>th</sup> paying P 9.2 million in 2010 (BIR 2010b; 2011). Thus in 2012, the tax office in his home-region Central Mindanao decided to file charges against Manny Pacquiao for failure to submit his complete 2010 tax records and violation of the National Internal Revenue Code. Pacquiao denied having done anything wrong and accused the BIR of harassment (PDI 28.03.2012). Nevertheless, the case was taken to the prosecutor's office and Commissioner Henares announced the BIR planned to review Pacquiao's 2008 and 2009 tax payments also.

In 2010, Boy Abunda, the Philippines' "King of Talk" and close friend of the Aquino family, became the BIR's new prominent supporter. In his function he has been engaged in the BIR's *Premyo Sa Resibo* project. Moreover Kris Aquino, TV host and President Aquino's younger sister, has been featured prominently as the country's top taxpaying celebrity in 2010. Several other members of Aquino's presidential celebrity endorsement campaign also have been presented as taxpaying citizens.

Activities geared towards forced tax compliance meanwhile were given centre stage in BIR tax administration reforms. Due to their centrality in the reforms, the programmes are discussed in the following chapter.

In summary, the analysis of BIR's change management in regard of tax administration reforms finds more weaknesses and shortcomings than good practices. Internal change management has been weak and external change management lacked persistence. What had been introduced on paper lacked implementation in practice. A distinct push for reforms and a clear and unequivocal commitment to reforms has been missing. Again, the impression is that vested interests have influenced certain directions.

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<sup>179</sup> According to Forbes from 06/08 to 06/12 Pacquiao's earnings amounted to US\$ 174 million, 2008: US\$ 40m, 2009: US\$ 42m, 2010: US\$ 25m, 2011: US\$ 67m. Pacquiao himself in his 2011 Statement of Assets, Liabilities, and Net Worth declared his net-worth P 1.352 billion (PDI 03.05.2012)

#### 5.4.4 Reform Dimensions

By 2001, the Philippines already had a long history of tax administration reform programmes. Many of the structural changes the Indonesian Directorate General of Taxes was to introduce in the upcoming decade had already been established at the Philippines' Bureau of Internal Revenue. For instance, headquarters had been reorganised and a large taxpayers office opened in the past. Commitment towards many of these modernisation and reform activities however has been deficient, leaving reform-oriented stakeholders disappointed about reform outcomes.

The latest tax administration reform programmes hence first tried to introduce a radical change by abolishing the BIR, which as described earlier failed, subsequently focused on computerizing business processes, which proceeded slower than expected, until emphasising programmes geared towards changing the behaviour of tax officials and taxpayers alike. The BIR finally declared the RIPS, RATE and *Oplan Kandado* its flagship programmes. The other programmes, projects and activities it had formulated in its various reform plans and strategy maps meanwhile proceeded in the background. BIR's status reports indicate that implementation has again been slow and scarce. They foremost stated that activities: have been discussed, planned, TOR are being prepared, drafted or under review, positions have been advertised, and procurement has started (BIR 2008c). The following sections concentrate on what has been implemented, the Bureau's flagship programmes.

The RIPS Revenue Integrity Protection Service originated from the "lifestyle checks" on high-ranking public officials, President Arroyo had introduced via the Presidential Anti-Graft Commission in 2003. The idea had been to detect officials misusing their authorities and powers for private benefit, by comparing tax officials' reported assets, liabilities, net wealth, and observed lifestyle with their official salaries and the reasonable way of living these would allow. Disproportions and inconsistencies make a suspect and probe further investigations.<sup>180</sup> If a suspect failed the lifestyle check the employee was threatened with legal charges, suspension or dismissal from service.

The BIR, BOC, and DPWH were defined as priority agencies; hence EO 259 of 2003 ordered the establishment of an anti-corruption arm at the Department of Finance, that is the Revenue Integrity Protection Service, and the establishment of Criminal Prosecution Groups at the Bureaus. Initially, RIPS operations were funded from the presidential contingency fund, departmental savings and donations from private persons and entities, later financial and technical assistance from international donor agencies, in particular the Millennium Challenge Corporation, gained in importance.

Under the supervision of the undersecretary for revenue, operations and legal affairs, the RIPS' official tasks have been to detect, investigate and prevent corruption in all of DOF's revenue generating agencies and their offices nationwide.<sup>181</sup> In particular it was to follow-up on complaints and hints submitted by the public to the RIPS via its hotline

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<sup>180</sup> The legal bases for the lifestyle check can be found in legislation passed far earlier, i.e. Republic Acts No. 1379 of 1955, No. 3019 of 1960, No. 6713 of 1989 and related anti-corruption laws.

<sup>181</sup> However, investigations initially focused on the Metro Manila area and parts of Luzon.

and webpage and to conduct related lifestyle checks. In case sufficient evidence against an official had been found, RIPS was tasked to file the appropriate charges with the Office of the Ombudsman and/or the Department of Justice.

With an original allocated staffing of 28 officers, all based at the finance department's central office, and 20,000 finance officials nationwide to be checked a difficult task to accomplish even if all RIPS officials were absolutely dedicated and integer (DBM 2008). Allegedly not all revenue integrity protection officers shared these values. During the years 2005 and 2006, accusations spread that some RIPS officials used their position to engage in syndicates and extort other finance officials in exchange for their exclusion from lifestyle checks or for favourable reports. Instead of being a tool against corruption, the RIPS for some of its employees allegedly had become another source of corruption. For the outsider, it is impossible to judge whether it were really the RIPS officials who were corrupt, or whether these accusations were part of yet another episode of contention between reform-oriented and reform-opposing factions, aimed at weakening the RIPS. Two characteristic stories serve as illustration:

Intelligence officer Joselito Fernandez was accused of having asked a revenue district officer for a bribe of P 200 thousand, in exchange for his exemption from investigation. If the revenue officer was not prepared to pay, he would be checked and even if he was innocent of any wrongdoing the RIPS's report could state otherwise. A deal was made initially, but following several 'money exchanges', the revenue officer reportedly changed his mind and informed the criminal investigation and detection group. Shortly after, another BIR official came out accusing Fernandez of having demanded P 500 thousand for a favourable lifestyle check report. In an entrapment Fernandez was caught red-handed and charged at the regional trial court (PS 09.09.2005; GMAN 12.08.2006).

RIPS officer Ruben Frugoso was accused of having demanded the release of smuggled goods at the (notorious) Port of Manila, if not the customs officials should prepare for public criticism (PS 11.12.2010). Both the Department of Finance officials, led by Frugoso, and the Bureau of Customs officials involved, led by Collector Rogel Gatchalian, subsequently filed legal charges against each other (ABS CBN 09.02.2011; MB 23.02.2011). Until mid-2012 Gatchalian remained untouched in his position as the Port of Manila Collector (BOC 2012), while the Department of Finance earlier claimed that Frugoso had been put on a "floating status" and faced charges before the Ombudsman, Civil Service Commission, and Court of Appeals (PS 17.12.2010).

His floating may have been introduced, during the RIPS's attempt to demonstrate its commitment to integrity, or alternatively to demonstrate its accommodating nature towards vested interests, amidst the extortion allegations against its staff members in mid-2006. Then, responsible Finance Undersecretary Gaudencio Mendoza announced that eleven RIPS officials "were stripped of their functions to conduct lifestyle checks" and seven officials "asked to leave the RIPS program ... Ruben Frugoso, Troy Pizarro, Reynalito Lazaro, Joselito Fernandez, Senen Castro, Ismael Leonor, and Virman Sayang-od" (PDI 12.07.2006). Shortly, after, the Office of the Ombudsman made public that it had received anonymous allegations of "ill-gotten wealth" against three finance

officials, among them Fernandez, and would recommend the filing of charges. Frugoso reacted with the filing of charges for unexplained wealth himself against Undersecretary Mendoza before the Presidential Anti-Graft Commission (PDI 25.10.2006).

It remains unclear whether the RIPS officials affected indeed were instantly removed from the Revenue Integrity Protection Service, where they were transferred to, and whether charges were filed. What is sure, is that Undersecretary Mendoza was lifted from his function, reportedly upon the demand of Senator Juan Ponce Enrile, Chairman of the Committee on Finance, following a controversial sin-tax decision lowering the excise tax rate on an international cigarette brand, by Secretary Teves in March 2008, and subsequently resigned (MT 28.02.2008; PS 18.03.2008). One can only speculate on the real motive behind. Was it legitimate or was it a plot?

Considering the Revenue Integrity Protection Service's shortage of staff, poor equipment, internal squabbles, as well as alleged occurrences of deviating behaviour, one would expect that the RIPS fell short of reform-oriented expectations. Unfortunately no consolidated database on cases investigated exists. At the time of interviewing, not even the Department of Finance knew exactly how much progress the RIPS had made. According to an interviewee, the only numbers they have "are dated". Hence, Table 5.3 presents the number of cases the RIPS is likely to have handled, as they were available.

TABLE 5.3: *RIPS – Revenue Integrity Protection Service, Cases Filed and Decided (2003-2011)*

Cases	2003	2004	2005	2006	2007	2008	2009	2010	2011
Total Filed	n.a.	14	13	43	n.a.	66	73	75	105
Officials						98	144	120	146
BIR officials		11		20					
Suspended				9				32	60
Dismissed				5				18	21

<sup>a</sup> The number of total cases filed and of officials involved are aggregates including staff from all offices related to the Department of Finance and including cases of previous years.

<sup>b</sup> No information is available on the alleged offences committed and the seniority level of the officials involved. Submission of an inconsistent Statements of Assets, Liabilities and Net Worth is said to have been sufficient, regardless of whether it was explainable or not.

<sup>c</sup> No clear information is available on the meaning of suspended and dismissed. There are however indications, that suspended can mean suspension from duty without salary for as little as one day and that dismissed can mean dismissed from the particular office but not from civil service as such. Further, it is possible that the officials dismissed have previously been suspended and are hence counted as both suspended and dismissed.

Sources: Data for 2004, 2005, 2008, 2009 and 2010 from the Department of Finance's Annual Reports, for 2006 from World Bank (2006: 60), for 2011 from the RIPS webpage.

While data are incomplete, an instant inspection of the figures already indicates that the Revenue Integrity Protection Service has been rather ineffective in raising the perceived risks of finance officials when using their public office for private gain. Until 2006, only a total of 43 cases were filed, nine finance officials ordered (preventively)



suspended and five finance officials ordered dismissed from their positions. The filing of cases further notably slowed down during the later third of Arroyo's presidency. Moreover, it remains unclear how many administrative and criminal charges were filed, if filed how they proceeded, and whether any decisions made were finally enforced. The few cases on which information is publicly available do not leave much room for optimism. The chances for public officials accused of graft and corruption of walking away remain high, be it that the evidence presented is not strong enough or that judges allegedly can be swayed by monetary incentives, persuasion or pressure from powerful individuals. The following cases in longer-term perspective illustrate this well:

The observation starts in year 2003, when PCIJ members conducted lifestyle checks on 25 BIR officials. The publication of their findings caused a great stir, as they found sufficient evidence that many tax officials owned assets whose origin they were unable to reasonably explain. Among others, the PCIJ alleged the assistant-commissioner for the enforcement service and BIREA president Percival Salazar; former assistant-commissioner of the large taxpayers service and of the tax fraud division, then regional director of Quezon City, Edwin Abella; former regional director of San Pablo City, then regional director of Makati City Lucien Sayuno; and former regional director of Quezon City, then regional director of Pampanga, Danilo Duncano; of owning property, vehicles, savings, business shares, and leading lives, far in excess of what would be reasonable in regard of their regular salaries (PCIJ 12-14.5.2003).<sup>182</sup>

Salazar's cases were dismissed for lack of evidence by the Office of the President in 2004, and for lack of probable cause by Ombudsman Gutierrez in 2007 (PDI 18.03.2012).

Abella was preventively suspended for six months in 2004, until, based on "substantial evidence", he was found guilty of dishonesty "for acquiring vast amounts of money and/or properties manifestly out of proportion to his salary and/or other lawful means" by Ombudsman Marcelo in 2005 (PS 12.03.2004; 01.02.2005). Shortly after the decision, Abella filed a motion for reconsideration which was left pending by the Office of the Ombudsman, probably until the impeachment and resignation of Ombudsman Gutierrez in May 2011. Abella remained a high-ranking BIR official throughout the years. Among others he was assigned to the office of Commissioner Tan-Torres as lawyer and co-chairperson of the BIR's newly created tax exemptions and incentives committee which was instructed to draft the revenue regulations implementing the related legislation passed by Congress. In July 2011, the Office of the Ombudsman declared, it had decided to deny Abella's earlier motion for reconsideration and to dismiss him from public office (MT 27.07.2011). His dismissal however did not last long: One year later the Court of Appeals, which has been filled with justices appointed by President Arroyo, reversed the Ombudsman's decision and reinstated Abella "to his

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<sup>182</sup> Based on BIR fiscal year 2003 collection statistics, the large taxpayer service was the most successful revenue region in terms of its share in total revenue collections of the BIR's twenty revenue regions, Makati City was ranked third, Quezon City fourth, and San Pablo fifth. Pampanga, Gloria Arroyo's home region, ranked seventh (BIR AR 2003: 60).

former position with payment of the corresponding backwages and other emoluments from the time of dismissal". In its ruling the Court wrote that it had found "no substantial proof to support the imputation that the petitioner received income from unlawful source/s and had unlawfully acquired properties ...". Further, "... intention is an important element in dishonesty – this was not substantially proven in this case" (B 11.06.2012).

Sayuno, who had decided to resign and return to the private sector after the allegations against him were made, was charged of perjury by San Pablo City municipal trial court in 2008 (PDI 01.10.2008). Whether any sanctions were ordered and enforced remains unknown to the public.

Duncano was similarly found guilty of grave misconduct and dishonesty by Ombudsman Marcelo in May 2005, and later filed a petition. His dismissal thus became not effective. Duncano, who was reassigned to BIR central office in 2003, pursued further his career, among others he became OIC-deputy commissioner of the resource management group (07/07-06/08), of the special concerns group (06/08-09/08), of the tax reforms administration group (09/08-03/09) and technical assistant at the office of the commissioner (since 03/09).<sup>183</sup> In 2009, the Office of the Ombudsman ordered the filing of charges at the anti-graft court (Sandiganbayan) and the demotion of Duncano. Duncano however soon was reappointed by President Arroyo (MS 23.07.2009). In March 2010, the Ombudsman's decision was formally "reversed and set aside" by the Court of Appeals (2010: 16), and in May 2011, the case was dismissed by the Sandiganbayan on formal grounds, as it believed that Duncano's right of speedy disposition was violated as the Ombudsman had filed the 2005 case only in 2009 (GMAN 24.05.2011).

Lower ranking tax officials overall may have a smaller chance to walk away, but their chances are still high enough not to deter any determined individual and motivate system's change. Until late 2012, the only tax official convicted ever heard of has been Dominga Manalili. A BIR cashier who had been sentenced by the Quezon City regional trial court to two life-terms and is said to have been imprisoned for diverting P 262 million in withholding taxes from ten government agencies to two unauthorised bank accounts between 1996 and 1997, which she withdrew in 2001. The cases against her four suspected accomplices were either dismissed instantly or sanctioned with temporary suspension for minor misconduct (PDI 09.11.2000; PS 05.05.2001).

The RIPS's counterpart programme has been the RATE Run After Tax Evaders Program. As its name suggests, the aim of RATE has been to investigate and prosecute tax evasion. In particular self-employed and professional individuals, such as accountants, businessmen, celebrities, doctors, and lawyers, were singled out. The BIR believed that foregone taxes from these groups account to at least 70% of taxes supposed to be collected (N 20.06.2005). With RATE, the BIR intended to show taxpayers that they "mean business" and tax evasion was no longer tolerated. Tax

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<sup>183</sup> Information obtained from the Bureau of Internal Revenue during field research.

evasion was to be regarded as a crime and violators would be caught and punished. According to various tax officials interviewed, the ultimate aim was to raise the taxpayers' "fear factor" and therewith increase voluntary compliance. The RATE similarly was established in 2005 and received substantial support from international donors.<sup>184</sup> Moreover, the programme similarly turned out to remain below expectations.

At its inception, the RATE programme set out the following criteria for cases to be filed: the case represents a criminal violation of the NIRC, the person to be charged must be high-profile known either to the general public or at least in the sector or industry he or she belongs, *prima facie* evidence is easy to establish, the case is easy to prosecute, and the estimated basic tax deficiency is at least P 1 million per year and tax type, priority should be given to cases above P 50 million (ADB 2009). According to President Arroyo's announcement, the RIPS was supposed "to file one tax case a week against affluent tax evaders" (GOP 2005: 6). Arroyo moreover declared that she would not care if the cases persecuted involved individuals close to the government (PDI 13.08.2007). Nevertheless, the official filing benchmark was set lower.

Cases were submitted to the Department of Justice (DOJ), until being forwarded to the relevant courts, i.e. the Court of Tax Appeals, whose jurisdiction therefore was expanded to include criminal cases, Regional Trial Court or Metropolitan Trial Court, if appropriate. The DOJ supported by the RATE was to prosecute these cases. According to the NIRC wilful violations to section 254, attempt to evade or defeat tax, are punishable with a fine of no less than P 30 thousand but not more than P 100 thousand, and imprisonment between two and four years. Violations to section 255, failure to file return, supply correct and accurate information, pay tax, withhold and remit tax and refund excess taxes withheld on compensation, are punishable with a fine of no less than P 10 thousand and imprisonment of not less than one year but no more than ten years. With imprisonment looming, if the RATE were effective, taxpayers' risk-calculations should be reversed. Contrary to the pre-RATE situation, tax evasion was to be regarded a high risk, and low reward activity.

Similar to the RIPS, due to poor case and data management, no consolidated database on the number of cases filed under RATE and the progress thereof exists. Table 5.4 presents the numbers as they were available. While different sources present different figures, and even the figures of the same source do not necessarily add up, the overall picture they present is consistent.

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<sup>184</sup> The MCC's overall grant amounted to US\$ 20.4 million, the RATE with US\$ 9.4 million was granted the larger share; the RIPS were allocated US\$ 1.4 million.

TABLE 5.4: *RATE – Run After Tax Evaders, Cases Filed and Decided (2005-2011)*

Cases	2005	2006	2007	2008	2009	2005-2009	2010	2011
Total Filed (DoF)	40	65		120	127	127		
Total Filed (BIR)						124	27	60
Filed (DoJ)	44	25	16	31	1	134		
Prosecution								
Recommendations						10	6	30
Indictment						7	3	22
Conviction					4	5	5	2
Sentenced						1	-	-

<sup>a</sup> The number of cases filed differs between different sources. Row 1 gives the numbers published by the Department of Finance, row 2 gives the numbers published by the Bureau of Internal Revenue. For years 2005 to 2009 the number of total cases filed are aggregates including cases of previous years. For 2010 and 2011 the numbers refer to the particular year. Row 3 gives the numbers published by the Department of Justice. 17 cases were filed in the pre-RATE campaign. Numbers present the cases filed in the respective year. Note that: 2005 includes the period March to December only, while 2009 includes the period January to May only.

<sup>b</sup> Statistics on the different outcomes of cases were published by the Bureau of Internal Revenue.

<sup>c</sup> According to the BIR, prosecution recommendations also stands for “resolutions in favour of the Bureau”, while indictment also stands “for filing of information before the courts, and sentenced includes “imprisonment”.

*Sources:* Data for 2005, 2008, and 2009 from DOF Annual Reports, data for 2005-2009, 2010, and 2011 from BIR (2012). Data for 2006 from the World Bank (2006: 60), data on annual cases filed from Carmona (2009; cf. ADB 2009).

The only figure which might impress on first sight is the number of total cases filed: according to the Bureau of Internal Revenue 124 cases from 2005 to 2009. Closer analysis however disappoints. Of the 124 cases filed, only ten were recommended for prosecution. Seven indictments, five convictions and one sentence were officially counted; it is unclear however, how many persons were involved in these charges and how large the estimated tax deficiencies were. According to Carmona (2009: 15), who was commissioned by the ADB to write a comprehensive report on closed RATE and RATS cases, “not all cases that were successful in preliminary investigation phase are considered large scale tax evasion, or covered by the RATE program”. The question is what accounts for such poor figures? Weaknesses in the Philippine justice sector do have an impact, for example there is a severe shortage of prosecutors and judges and facilities deteriorated with falling budgetary allocations. This results in case-backlogs and poorly prepared cases (World Bank 2011: 48f), but fault lies also with the BIR itself. In filing cases, the tax agency seems to have been driven predominantly by the desire to fulfil international donors’ monitoring and evaluation indicators, disregarding the quality of the cases filed (see Chapter 5.4.2). Based on the quantitative filing indicator the BIR could claim that they had surpassed their goals set, and the MCC was able to maintain that their mission had been successful and that the project had accomplished its task. This was enough for the BIR to secure further funding, and for the MCC and its consultants to prolong their engagement.

Somehow dubious has also been the single case which so far has led to a sentence and a warrant of arrest.<sup>185</sup> In 2009, the Court of Tax Appeals, following four years of court proceedings, sentenced Gloria Kintanar, a middle-class businesswoman, to two to four years of imprisonment, a P 20 thousand fine and payment of back taxes and interests, for failure to file her income tax returns in the years 2000 and 2001. Including surcharges and interests, the disputed amount was about P 6.3 million (CTA 2009). Kintanar appealed, and the case was taken to the Supreme Court. In January 2012, the Supreme Court however upheld the CTA's decision. Based on these decisions, the BIR sought a writ of execution, a warrant of arrest, as well as a hold departure against Gloria Kintanar (PS 21.03.2012). Before these had even been issued by the courts, Kintanar already tried to flee but failed (GMAN 04.05.2012). Later she missed court proceedings due to health reasons she had claimed, and allegedly successfully fled from the hospital where she had been put under arrest (PS 03.07.2012). Her whereabouts remain unknown. This and the case's circumstances leave room for speculations. Why was it that Gloria Kintanar's case was pursued until that stage and not the case of any of the country's other countless alleged tax evaders? Has there been elite influence involved?

Gloria and her husband Benjamin Kintanar in the late 1990s, early 2000s became famous as the nation's top distributors of Forever Living Products Philippines (FLP), a multilevel marketing company.<sup>186</sup> Benjamin Kintanar was declared a network marketing legend, having made it from jeepney driver to Ferrari driver and multi-millionaire, by selling aloe health care and nutritional products as well as recruiting new distributors, within a few years only. Since, he appeared in various media-outlets nationwide showing Filipinos what he had achieved and trying to convince them that everyone else who was willing could easily achieve the same by joining FLP. FLP was founded by the politician Roilo Solis Golez in 1991, and has since become one of the Philippines' 500 most successful corporations. Investigations into the Kintanars' cases were initiated in the early 2000s, by July 2002 a first access letter was issued by Armando Rosimo, chief of the BIR's tax fraud division. In early September 2003, Rosimo issued a letter to the Kintanar's informing them of the investigation results, a little over a month later Rosimo was shot dead by unidentified gunmen (see CTA, SC Proceedings 2009-2012). The question of whether these were all merely coincidences or whether there has been a plot so far has remained unanswered. Coincidences would be the preferred answer, as a

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<sup>185</sup> Until mid-2012, at least two other individuals were sentenced, Gloria Kintanar's husband Benjamin Gatpayat "Jun" Kintanar Jr. (CTA Criminal Cases No. 0-030, 0-031, 0-032), and celebrity cosmetic surgeon Joel C. Mendez (CTA Criminal Cases No. 0-03, 0-015). Other cases are still being processed.

<sup>186</sup> In multilevel marketing, distributors earn from recruiting as well as the marketing and selling of products. FLP markets itself as "the greatest opportunity in the world"; in a very short period of time returns would far outnumber the salaries of well-educated employees, allowing member distributors to invest in property and cars. Everyone can join; one would only have to pay an entry fee of approximately P 12 thousand and purchase FLP products to be sold. According to the Consumer Act of the Philippines (RA 7394), multilevel marketing is legal and a legitimate business. For a critical view on multi-level marketing in the Philippines, including Forever Living Products Philippines Inc, see Max de Leon in MT 28.04.2003.

plot would be just another indicator that the power of “guns, goons, and gold” is still alive in the Philippines, affecting also the tax system.

With RATE having largely failed to deter tax evaders and tax amnesties further undermining tax collections, Commissioner Esquivias initiated the *Oplan Kandado* Program (RMO No. 3-2009). By immediate sanctioning of business owners in violation of the NIRC through suspension of business and temporary closure, the BIR sought to increase the motivation of business owners to comply with the formal regulations. Revenue district offices nationwide were given targets on how many businesses they were to close; the decision on which businesses to close was left largely with the heads of the district offices. Selection criteria were broad, including the failure to register, to issue receipts, to file a tax return, and understatement of sales, hence left room for discretion. According to tax officials interviewed, the selection of affected businesses has not been without elite influence and interference. Relations to an influential individual could prevent or at least stop closure orders. Hence, it comes of little surprise, that it were predominantly small to medium-sized stores, supermarkets, restaurants, and warehouses which were padlocked and sealed with as much publicity as possible.

According to the BIR, in 2009 about 400 businesses were temporarily closed nationwide. Most of these reopened after the minimum closure period of five days, following the rectification of the violation, and payment of deficiency taxes and penalty fees. Generally, no further criminal charges were filed. Therefore, a valid conclusion of the *Oplan Kandado* Program would probably be that it has been successful in raising VAT collections, albeit additional collections were small compared to the BIR's overall tax target, but less successful in initiating the intended change of mind in Philippine tax evaders. With *Oplan Kandado* the risk has indeed increased, but only in so far as businesses were put in a big lottery bowl. Only if caught, taxes and a surcharge would have to be paid. Statistically, tax evasion remained a high reward and low risk activity.

Under President Benigno Aquino and Commissioner Henares, BIR reforms regained in speed and vigour. RIPS, RATE, and *Oplan Kandado* were continued, and the emphasis on re-engineering the Bureau of Internal Revenue's core business processes increased. Implementation however persisted to be slow.

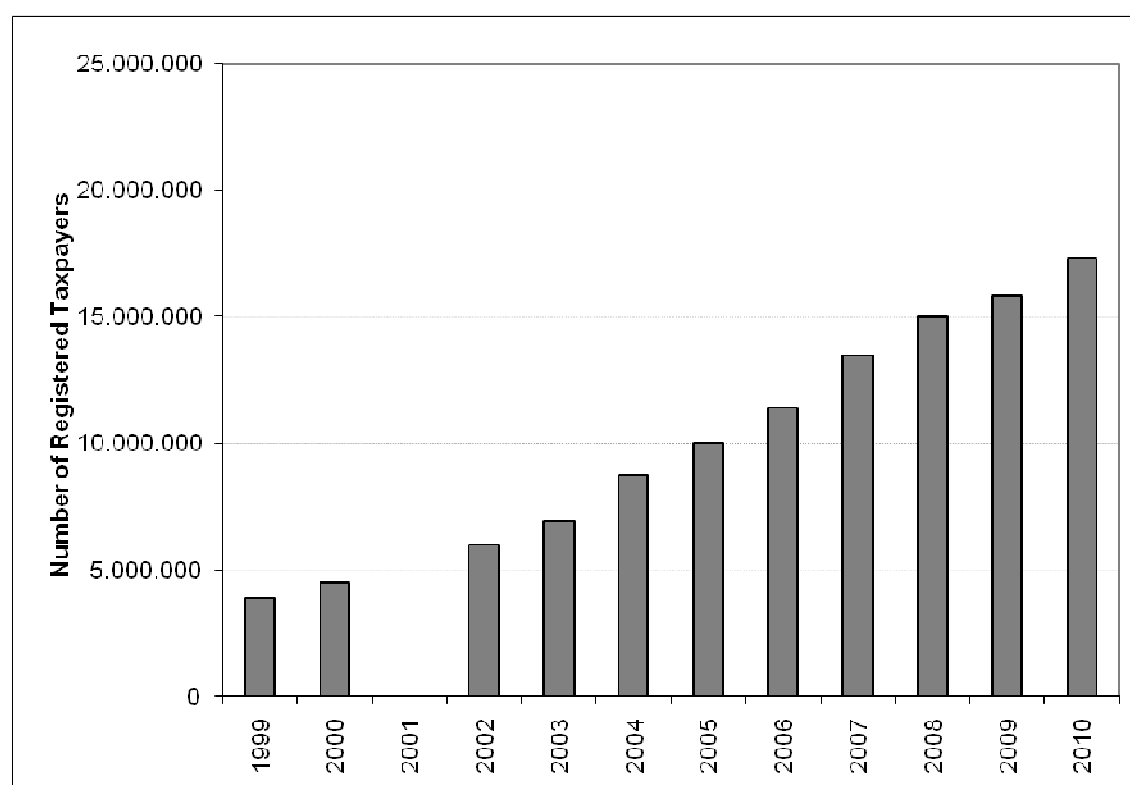
In summary, in-depth analysis of the BIR's reform dimensions indicates that reform plans have looked good on paper only. In implementation much remains to be desired. While many activities have been planned, only few were really pursued. And even those flagship programmes that have featured prominently remained below expectations. RATE, RIPS and *Oplan Kandado*, which were geared towards changing tax officials' and taxpayers' risk-calculations have not achieved their goal. So far, attempts of wide-ranging organisational reforms have been blocked. Elite influence and interference was perceived in many areas. Under these circumstances, significant improvements in tax administration seem unlikely.

## 5.5 Indicative Outcomes of Reform

### 5.5.1 Revenue Performance

With reforms ongoing, it is impossible to evaluate the impact of the tax administration reform measures discussed above conclusively. Yet, what can be done is to identify first tendencies. Within the last decade, as Figure 5.9 shows, the BIR has steadily increased the number of registered taxpayers. From 1999 to 2010, the number has more than quadrupled, increasing from 3.9 million to 17.2 million registered taxpayers.

FIGURE 5.9: *Total Number of Registered Taxpayers, Philippines (1999-2010)*



<sup>a</sup> The BIR has only published registered taxpayers in its annual reports since 1999. As prior data was also impossible to locate from any other source, previous developments are unknown.

<sup>b</sup> The total includes corporate taxpayers (taxable, exempt), individual taxpayers (compensation income earners, business/professionals), estate and trust taxpayers, marginal income earners, one-time taxpayers (ONETT) and others (EO No. 98 and Non-Resident Citizens).

Sources: Data from BIR Annual Reports (various issues).

Credit is due to BIR tax mapping and tax verification drives, as well as more rigorous requirements in both work and public life forcing Filipinos to apply for a taxpayer identification number. The comparatively larger increases in the years 2004, 2007, and 2010 further indicate that tax amnesties might have motivated some Filipinos to register. Here however, the increase most likely has remained below expectations. As such the Philippines' tax potential remains large; neither the country's entire labour force, which by law are obliged to register, nor its corporations have been fully tapped.

By 2010, as indicated by a comparison of BIR statistics on registered individual taxpayers and NSCB statistics on labour and employment, less than half of the individuals employed in the industry and services sectors were registered.

As Table 5.5 indicates, transforming potential taxpayers into compliant taxpayers has remained a considerable challenge. Notably, the quadruplication of the tax base has not led to increased tax collections in relative terms. On the contrary, the general trend has been that of a declining share of BIR tax revenues in the country's gross domestic product. Collections decreased across virtually all major tax types classified by the BIR.

TABLE 5.5: *Revenue Performance Indicators, Philippines (FY 1996–2010)*

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010
Total	12.0	13.0	12.7	11.5	10.8	10.7	9.9	9.9	9.6	10.0	10.8	10.7	10.5	9.8	9.6
Income	5.67	6.11	6.23	5.67	5.66	5.75	5.40	5.37	5.43	5.70	6.01	6.20	6.25	5.42	5.43
Excise	2.01	2.34	2.13	1.90	1.72	1.51	1.36	1.25	1.16	1.09	0.93	0.80	0.80	0.75	0.75
VAT	1.70	1.76	1.61	1.70	1.50	1.52	1.57	1.82	1.57	1.55	2.25	2.10	1.82	2.10	1.92
Percentage Tax	0.76	0.76	0.69	0.68	0.68	0.69	0.57	0.42	0.55	0.61	0.61	0.60	0.53	0.53	0.49
Other	0.70	0.74	0.77	0.57	0.51	0.50	0.50	0.50	0.55	0.62	0.62	0.66	0.70	0.54	0.54
TRCR	n/a	n/a	n/a	58.4	59.2	n/a	37.0	11.7	8.8	8.9	7.5	6.3	5.8	5.3	4.8
COCR	0.8	0.7	1.0	1.0	n/a	1.3	1.0	0.8	0.8	0.7	0.6	0.6	0.7	0.8	0.8

<sup>a</sup> Tax revenues, according to the Philippine government's definition, are presented as percentage of GDP. As only domestic taxes collected by the BIR are considered, the total percentage should be lower than tax ratios listed in other sources, but more accurate for capturing the likely influence of tax administration reforms. The total has been taken from official BIR calculations; where diverging figures for a year were found the more recent was chosen. Disaggregated tax revenues, broken down to the Philippines major tax types, are own calculations based on raw data from BIR and NSCB. The figures do not add up. DGT and BIR reporting standards differ, thus data comparability is restricted.

<sup>b</sup> The annual income tax return compliance ratio (TRCR), other than for Indonesia, due to missing data on BIR requests of tax returns, was calculated by comparing the BIR statistics on registered taxpayers with BIR statistics on the comparative number of annual income tax returns filed by type of return; here the grand total was chosen. It follows, that the TRCR for the Philippines necessarily is lower than for Indonesia. Comparability therefore is restricted, but trends should nevertheless be interpretable. The sharp decline in 2003 is explained by the introduction of RR No. 3 of 2002, Substituted filing of income tax returns of payees/employees receiving purely compensation income, which exempts individuals whose sole income has been subjected to final withholding tax from filing an income tax return.

<sup>c</sup> The cost of collection ratio (COCR) is calculated based on a calculation of administrative costs incurred to revenues collected. As there are many factors that can influence the ratio, and it ignores revenue potential, it needs to be interpreted with special care.

*Sources:* Author's calculations based on data from BIR Annual Reports (various issues) and NSCB (2012a).

Following an all-time high at 13% of GDP in 1997, the BIR's overall tax effort severely contracted until reaching a low at 9.6% of GDP in 2004. Manasan (2003b: 3) attributed the decline to changes in tax policy, i.e. tax measures with a negative revenue impact, and increased tax evasion as a result of declining collection efficiency (see Chapter 5.3.3). Changes in the structure of the economy had only a marginal impact she believed. Also, the temporary improvement in 2005 up to 2006, when a tax effort of 10.8% was achieved, was more the result of tax measures with a positive revenue impact enacted by Congress in a situation of looming fiscal crisis, than caused by



improvements in tax administration. The reformed value-added tax (RVAT, RA 9337), expanding the VAT's coverage and increasing the rate from 10% to 12%, led to a significant increase of VAT collections (Aure 2011). Gains however were unsustainable. The tax effort declined more than a percentage point from 2007 until 2010. As the Philippines proved comparatively resilient to the global economic downturn the reasons for the drop have to be located elsewhere. The World Bank (2010: 29) believed that a "slowing economy ..., recent tax policy and administrative measures such as the effective tax cut on personal income tax (July 2008), and on corporate income (January 2009), the weakening of the Large Taxpayers Service (LTS) of the BIR (May 2008), and negative incentives that the Attrition Act generates ..." had been among the key reasons.

Overall, excise taxes, also known as 'sin taxes', specifically on alcoholic beverages and cigarettes declined most sharply. Legislation aimed at increasing excise tax collections proofed ineffective, as Congress had failed to index taxes on sin products to inflation and retained brand classifications of 1996. The biggest beneficiaries have been Philip Morris Philippines Manufacturing Inc. and Fortune Tobacco Corporation, which control more than 90% of the Philippine cigarette market. Both companies merged in 2010. Lucio Tan acts as the chairman of the equity joint venture PMFTC Inc (PS 22.07.2010; see Chapters 5.3.2, 5.4.1). Only in late December 2012, President Aquino was able to sign a new sin tax bill into law (RA 10351). Government judged it a great breakthrough although the final law promised to raise only half the additional revenues the Department of Finance had envisaged (BM 20.12.2012).

The analysis shows that the Philippines' tax potential still is far from being exploited. Indirect taxes, which are easier to implement than direct taxes, continue to constitute a major source of revenue collections. The development of income tax collections and of the tax return compliance ratio indicates that the BIR remained weak in enforcing compliance. At best, so far there has been little improvement. At worst, the BIR's performance even deteriorated during the last decade. Both do not indicate reform success. – A lot remains to be done with respect to implementation.

### **5.5.2 Taxpayer Attitude and Opinion**

Overall, the Bureau of Internal Revenue did not gain much ground in establishing the image of a credible office among Philippine citizens. The tax office regularly send out the message that it ranks among the top five most compliant agencies, of more than one hundred agencies participating, on the government's 22 anti-corruption efforts score card, divided into prevention, education, deterrence and strategic partnership strategies, under the Presidential Anti-Graft Commission's Integrity Development Action Plan (see NEDA 2004). According to the BIR (2005: 1) "This repudiates the prevalent perception

that the BIR is graft-ridden". The public however gave little credence to these messages.<sup>187</sup>

The public doubted real change in the BIR as independent public opinion surveys indicate. Pulse Asia's 2011 nationwide survey on corruption shows that the BIR is still perceived one of the country's most corrupt agencies, ranked fourth after the Armed Forces, National Police, and Department of Public Works and Highways (PS 29.03.2011). Similarly, on Transparency International's Bribe Payers Index 2008, the Bureau of Internal Revenue received a rating of 4.1 on a 5-point scale; with 1 defined as not at all corrupt and 5 as extremely corrupt (TI 2008). More than 20% of companies surveyed expected to give gifts in meetings with tax inspectors, and 10% of households admitted they paid bribes when in contact with the revenue authorities (World Bank/IFC 2009: 9; TI 2011). Both figures range above the averages of comparable countries.

Social Weather Stations (2008; 2009) asked more than 400 managers of enterprises in Metro Manila, Cebu and Davao to rate 30 government agencies in terms of their sincerity in fighting corruption. The BIR receiving net-ratings of -56, respectively -57, was perceived amongst the most insincere. Ratings beyond -50 are defined as very bad; only the DPWH and the BOC were rated worse.

Surveys directly asking Filipinos on their perception of the BIR's various reform efforts and their general satisfaction with the services provided by the BIR, despite multiple announcements in the Department of Finance's and Bureau of Internal Revenue's strategic plans, so far either have not been conducted, or the results have not been made available to the public yet.

## 5.6 Conclusion: Philippines Case Study

This chapter provided a detailed politico-economic analysis of taxation in the Philippines and gave a cohesive narrative of recent Bureau of Internal Revenue reforms. The case study evidence indicates that the Philippines has been a strong example of a country which has great difficulties in domestic tax collection even when it is in dire need to raise revenues to finance common goods and keep its budget consolidated. Finding the necessary leverage for reforms has been notoriously difficult.

Formal taxation has been introduced by the Spanish and further professionalised by the United States colonial power. Training of Filipinos, however, has been deficient. While formally much of the tax administration has been organised according to modern practises, informally neopatrimonial practises have prevailed. Path dependence is prominent in many aspects. Personal contacts with influential personalities in many cases turned out to be at least as important in obtaining a particular job as qualifications and merit. Elite interference in human resource management and day-to-day operations reportedly has occurred frequently. Exchange of favours has been common practise.

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<sup>187</sup> Probably, also President Aquino, as he ordered the abolishment of the PAGC viewing it as a redundant commission (PS 21.11.2010).

While the tax administration has been underfunded and tax officials' salaries have been low, the public perception has been that working at the BIR has constituted a road to riches. Weaknesses in tax administration had an impact on revenue collections; these were aggravated by inadequate tax policies. The perception is that Philippine tax collections have been undermined by vested interests.

Since Marcos times, Bureau of Internal Revenue reforms have been regular features of the Philippine taxation regime. Several major reforms were introduced with the assistance of international cooperation partners. Attempts have been made to reform both tax policies and tax administration. Major concerns have been to raise tax rates, broaden the tax base and computerize the BIR's business processes. The replacement of the Bureau of Internal Revenue by a semi-autonomous revenue agency was discussed several times. Reform success, however, has been elusive.

The taxation structure has remained inadequate and ineffective. The Philippines continue to collect far less taxes than the estimated tax potential would allow. The tax burden falls disproportionately on corporations and salaried workers. In relation to their financial means, high-wealth individuals contribute far less than middle-class individuals. Tax exemptions and tax amnesties are frequent; moreover the leeway for tax negotiations is large. A significant number of Filipinos remain outside the tax-net; those in the net generally are not fully assessed. Data collection, data exchange and data processing are flawed. Both internal and external accountability mechanisms have proven ineffective. While the need to collect domestic taxes has been acknowledged by most Filipinos, both inside and outside government, so far it has been impossible to establish the necessary support to implement large-scale reforms.

On the contrary, in particular under Arroyo, while the rhetoric on reforms has been strong and numerous strategy plans for reforms have been formulated, the implementation of reform projects has been routinely disturbed both by outside and inside forces. The executive financial management team has been highly unstable; the rotation of staff holding strong influence on the reform process, such as the director general of taxes, was high. The analysis of personal backgrounds of individuals appointed and their motivations for resigning after only short periods of time indicated influence of powerful vested interests. Parliamentary support for reforms has been weak. The BIR has been underfunded; the exemption of BIR personnel from the salary standardization law has been pending, few additional funds have been provided. Both strategizing and implementing capacities for reform within the BIR have been low. The division established for the management of reforms for many years has been only an adjunct to the BIR making it an unpopular option for career conscious tax officials. Only very few highly dedicated tax officials were attracted to the unit and committed to make serious personal contributions. By systematic weakening, before reforms had the chance to take off ground, they had already been slowed down until they stopped.

Ownership and leadership of the Philippine government in tax reforms appeared low. The impression gained has been rather that attempts were made to please international donors to secure further funding. What the Philippine government sold as stories of

reform success upon closer investigation rather showed the contrary. At best, it showed stagnation; at worst, it showed regression. A lot has been done, yet no real outcome has emerged. BIR's flagship programmes emphasized changing the behaviour of tax officials and the general population. Diverging behaviour, unproductivity and tax evasion, so the message, were no longer accepted. Yet, throughout the programmes' duration not a single tax official has felt serious consequences and only one alleged tax evader has been issued a warrant of arrest; that person however has been missing and is not serving her sentence. The BIR has hardly managed to increase the fear factor as it had announced. Fault however, lies not only with the tax authority. The environment within which it operates has been notoriously difficult. There are many indications that reforms depend on what is politically feasible.

Arroyo's successor, President Aquino has given more evidence to this point. With a strong political mandate, he has reinvigorated the fight for tax reforms. More stability has been introduced and the management division has both strengthened and institutionalised. Optimism about the prospects of tax reforms increased among the Philippines' financial management team and international cooperation partners. Some achievements have been made, yet a major breakthrough is still awaited.

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## 6 Conclusions and Implications

Within the last decade, taxation in developing countries has become an increasingly important topic among academics and development practitioners. Unstable international financial resources and the perceived additional benefits of domestic taxation for the overall quality of state governance led the international community to call for increased domestic resource mobilization. A tax ratio above 20% of the gross domestic product was defined as a general minimum target. Many developing countries fall well below this target. This has given reason for concern, as it is assumed that lower tax ratios impede development, and tax ratios below 10% do not even suffice to sustain basic living standards. Central to the debate has been the claim that sustained fiscal consolidation and socio-economic development hinged on domestic commitment and international cooperation. Initiatives to strengthen tax systems thus proliferated globally. Programmes for tax modernization and reforms gained in prominence.

While the body of research on tax issues is growing, accessible knowledge on tax systems, the reasons for poor tax collection and the main determinants of relative reform success has remained scarce. With little research done so far, this has been particularly true for countries in Asia and the Middle East.

Against this background, this study explored the dynamics of taxation in Southeast Asia. By a structured and focused political economy analysis of taxation and tax reforms in Indonesia and the Philippines, it described how the tax administrations are organised formally, it examined how they function in practise, what accounts for shortcomings and weaknesses in taxation, how recent reform processes have been structured, and finally explored what accounted for the reform path taken. In its theoretical approach, the study built on actor-centred institutionalism, conceptually, it applied neopatrimonialism as its main analytical lens. The study highlighted taxation as a fundamentally political issue and in its case studies it analysed both the roles of formal and informal institutions and actors, as well as their interactions.

Based on theoretical guidance, the core argument put forward in this study has been that legacy-driven variations in neopatrimonialism are highly influential in determining the shape and direction of the tax system. Assuming that taxation generally is not in the interest of economic elites, when it threatens their vested interests, the presumption is that efficient taxation is not favoured. Thus, variations in power concentration are of particular relevance. Power concentration refers to the degree of economic elite capture of politics and bureaucracy. The more power, therewith influence and control the elite have on these two central domains of the state, the more it is able to introduce and sustain policies and actions in their favour.

In regard of tax reforms it was thus hypothesized that substantial reforms are the less likely the more disproportionate elites' influence. The more detached the ruling class is

from the masses and the less elites circulate the more likely is a tax system reflecting vested interests.

Path dependence implies that the system in place by and large is resistant to change. Yet, past evidence has shown that extant institutional and structural factors do not predetermine outcome. Human agents choose directions. Agency can overcome institutional constraints and hence lead to change. Thus, effective change management, comprising strong political will, leadership and a coherent mid- to long term strategy was considered capable to overcome structural obstacles and introduce change.

The empirical evidence gained from the two case studies supports the validity of these hypotheses. In the following, this chapter further substantiates this inference. It draws the individual threads together, explains how they contrast each other and belong together. The chapter then draws implications for scholarship and policy, and concludes with suggesting directions for further research.

## **6.1 Main Determinants of Relative Reform Success and Failure**

Two ASEAN member states stood in the centre of this study: Indonesia and the Philippines. Confronted with growing fiscal pressures, both countries share the urgent need to mobilize additional domestic revenues to achieve and sustain consolidated budgets. In this regard, both governments publicly expressed awareness about the importance of taxation and the values and potential benefits of a modernized and reformed tax system.

Since the early 2000s, with international support Indonesia and the Philippines have introduced high-profile efforts to modernize and reform their tax administrations. After almost a decade of reform activities, Indonesia was widely regarded as the comparatively more successful reformer. While there is substantial agreement among observers and those directly involved in the reform process that Indonesia's Directorate General of Taxes has still a long way to go to fulfil its vision and mission statements, all stakeholders acknowledged that some progress has been made. Assessments of the Philippines' Bureau of Internal Revenue were less favourable.

The systematic comparison of the individual variables analysed in this study brings us closer to understand why. Foremost, there is evidence that in explanatory power political variables carry more weight than economic variables. It is not the option which is economically desirable that gets adopted, but the option which is politically feasible. Both case studies support the argument that institutions structure, not determine, politics. They shape human behaviour, yet human agency also shapes institutions. Human agency is crucial for introducing change.

A summarizing simplified assessment of the study's various independent variables' impact on the successful implementation of the tax reforms is presented in Table 6.1. A plus symbolises a positive impact, while a minus symbolises a negative impact. The number of pluses and minuses next to each other illustrate the perceived particular

strength of the impact. A plus and a minus next to each other stand for a neither distinctly positive nor negative impact on the directions of the reform process.

TABLE 6.1: *Independent Variables' Effect on Relative Reform Success*

Variable	Indonesia	Philippines
National Context of Reforms		
<i>Neopatrimonial Profile</i>	--	---
<i>Public Administration Profile</i>	-	-
<i>Socio-Economic Development</i>	+	+-
Administrative Conditions of Reform		
<i>Evolution of the Tax Administration</i>	-	-
<i>Human Resource Management</i>	-	-
<i>Business Operations</i>	-	-
<i>Administrative Accountability</i>	-	-
Process of Reform		
<i>Domestic Actor Constellations</i>	+-	--
<i>Donor Influence</i>	+	+
<i>Change Management</i>	+++	+-

Source: Author's compilation.

In this chapter, instead of repeating all findings in detail, the focus will be on those aspects where significant differences in relation to the progress of reforms between the two case studies were found. These are the variables of power concentration and change management. In inference and their interpretation certain aspects of the variable domestic actor constellations are considered, as analysis proved that important evidence on power concentration and change management characteristics turns visible here.

Summaries of the reasons accounting for weaknesses and shortcomings in taxation and the particular characteristics of Indonesia's Directorate General of Taxes and the Philippines' Bureau of Internal Revenue story are presented in the conclusions of the case studies.

#### *Power concentration and its impeding effect on tax reforms*

The case studies have shown that contemporary Indonesia and the Philippines are divided by one major difference: power concentration. Power in the Philippines is significantly more concentrated than it is in Indonesia. The economic elite is more detached from the non-elite and elite circulation is more restricted: Less than two hundred family clans rule the entire country. For decades the same families, which are firmly rooted in their localities, have dominated both business and politics. In every Congress about 60% of representatives are members of political clans. The Philippines' most wealthy and powerful divide public offices amongst each other. Nearly all members of Congress belong to the 0.1% of Filipino families which earn at least P 2.4 million a year. The wealth-gap between Filipino district representatives and the average

Filipino family is very large. Politicians' business interests tend to be strong. With a highly particularistic political system, the incentive to build a personal vote has been particularly strong. Against this background, the role of political parties has been notoriously weak. In contrast, Indonesia's elite is more diverse and less the result of dynastisation. By 2009, about 65% of elected lawmakers were new to the national parliament. Yet, the country's economic elite remains overrepresented. The wealth gap between politicians and ordinary citizens is large. About 40% of national legislators hold a business. Overall, the identification with political parties has been stronger.

As pointed out in the conceptual framework of this study, several scholars have argued that redistributive reforms are the less likely the more exclusive and privileged a nation's elite. The basic assumption is that these elites enjoy tremendous advantages, thus benefit from maintaining the status quo, and hence block the reforms of economic institutions that would endanger their personal resources and the adoption of country-wide policies that would weaken their personal standing.

The analysis of taxation reforms in Indonesia and the Philippines has provided ample evidence in support of this argument. Initiative for reforms intended to achieve a more effective, efficient, equitable and impartial tax system has clearly not come from the legislatures. As such tax issues rarely have made it to the plenary.

The Philippine Congress has either blocked or severely weakened reform initiatives from the Department of Finance. Within the last decade more revenue-eroding than revenue-enhancing laws have been passed. In relation to their personal income and assets the middle class carries a much heavier tax burden than the upper class. Tax incentives are prevalent and loopholes in tax policies and tax administration deliberately kept open. The wealthy have significant financial means and personal connections to avoid and evade taxes. These, they use. Interference in human resource management decisions and the day-to-day operations of the Bureau of Internal Revenue have been frequent. Further, the provision of public goods and services are regularly advertised in the receiving communities as if they were funded by the local politicians themselves. This undermines a general appreciation of taxation's benefits in society. Legislative support for tax administration reforms has been elusive.

The Indonesian legislature has been more supportive. Support, however, has not been unequivocal: politicians permitted reforms in general, yet limited their scope to elite-defined boundaries. While financial means for tax administration reforms were passed, revenue-enhancing tax policy reforms have found it much harder to be adopted. Overall, interference in the Directorate General of Taxes' human resource management decisions and day-to-day operations has been comparatively rare. So far, Indonesia's legislature personally has less to lose than their Philippine counterparts. The background of politicians is more diverse than their counterpart's. Also, the Indonesian political system is less particularistic, which gives more meaning to taxation.

Both in Indonesia and the Philippines the president plays a central role in initiating and pushing for reforms. Under authoritarian government, reforms had depended upon the president's decision. Reforms were possible when the president chose to reform.



However, since democratisation, the strength of support the president has been able to give has been increasingly dependent on the relationship the executive holds with the legislature. The redistribution of powers, in relation with the increase in veto-players, has made change less likely. The president's mandate and legitimacy is bound to be challenged in the political contest. Political transactions play a crucial role for both the substance and the path of reforms. The weaker the president's mandate and the more questioned her/his legitimacy the more difficulties s/he will have to prevail in the political game. To secure support, solve conflicts and avoid looming deadlocks, executive preferences for tax reforms may succumb to legislative preferences for continuity. Costs are weighed against each other. The costs of pushing for reforms may be perceived as too high in view of what is politically at danger to be lost.

The Philippine case illustrates this well. At the beginning of Gloria Arroyo's presidency, she promised to control the national budget deficit by increasing tax collections and more prudent spending. Her demands and public support for tax reforms had been strong. At that time, tax reform initiatives had been bold and individuals appointed to the country's key financial management positions known as reform-oriented professionals. Economic considerations still prevailed over strategies of political survival. Her later shift in orientation is apparent in the course of tax reforms' more recent history. The more Arroyo came under pressure and felt that the legitimacy of her presidency was questioned, the more she allowed tax reforms to falter.

Vested interests gained the upper hand. Fiscal management positions became a revolving door. The secretary of finance, the undersecretary for revenue operations and legal affairs, as well as the commissioner of internal revenue were frequently replaced. Notably, the Bureau of Internal Revenue experienced six different commissioners during Arroyo's presidency. This translates into an average tenure of 1.5 years. Anecdotal evidence indicates elite interference in many of these human resource decisions. The replacement of the management resulted in the discontinuity of reform initiatives and frequently changing reform priorities. Evidently, the impact on tax administration reform's progress has been negative.

The Indonesian president's position towards the legislature has been stronger than his Philippine counterpart's. The legitimacy of his presidency has been unquestioned and his personal popularity among the Indonesian public has been high throughout the period of reforms analysed by this study. This has been of advantage for Yudhoyono in pushing for reforms. It allowed him to appoint technocrats to the key positions in financial management and provide them with much of the political backing and support needed. Yet, also the Indonesian executive has been unable to entirely mitigate opposition. When the reforms became 'too dangerous' elites interfered. Backroom-deals between the president and leading politicians are widely believed to have pressured the Finance Minister, who was perceived as the reform's architect, to resign. Within Indonesia's multi-party system the president had to secure further support for his government; here striking deals with party leaders has been a central strategy. The support of individual powerful elites with strong business interests probably was

indispensable for decision-makers. The impact on tax administration's progress has been negative, but not as detrimental as in the Philippines. Both the personal qualities of individuals appointed to key positions and their terms in office remained good enough to proceed. Reforms lost in speed, yet were not stopped.

### *The importance of change management*

Resistance to reforms has not only been strong among the economic elites, but also amongst the tax administrators affected. Personal uncertainty about the outcome of reforms and the effects these would have on the individual tax official trigger a status quo bias. Anxious about negative effects suggested reforms might have, a natural human reaction is to prefer the situation not to change but to continue with the familiar. Similarly, there tends to be little public pressure for tax reforms, as the general public is likely not to be aware of the potential benefits. The popularity of taxes is low.

The status quo bias needs to be addressed. For reforms to have a chance of being introduced and implemented, resistance needs to be contained, reformers strengthened and support from those indifferent to be won. In democracies reform does not simply come by instruction or order. As the case studies have underlined change management is crucial. Its character and strength influence significantly the scope reforms can reach. There is evidence, that effective change management is sustained over an extended period of time, follows a coherent strategy, and addresses both internal and external stakeholders. The change management strategies in Indonesia and the Philippines differed markedly. In both cases the impact on the reform process has been recognisable. In the case of the Philippines the impact has been negligible at best, counterproductive at worst, while in Indonesia it has been more supportive.

Foremost the character of the leadership provided in the reform process has been important in shaping the directions of reform. The case studies show that it is not only the personality of leaders but also the frequency of personnel change that has a significant impact on the progress of reforms. A high turnover rate slows down or even brings reforms to a standstill, while a reasonably long tenure of personnel increases the chance of reforms to progress. Turnover interrupts the continued implementation of reform activities. The analysis has shown that change at the top regularly is followed by a change of policies. This makes a coherent reform strategy unlikely. Rather short term activities are introduced; at times these might be complementing, but at other times they may also be contradicting each other and reversing those policies that had been introduced earlier. For a second, frequent rotation in positions in the key areas of reforms, such as positions in large taxpayer offices or in the information technology department, prevents individuals to build expertise. Training might not lead to the change desired as personnel once sufficient knowledge has been accumulated is already transferred out of the department. This way the progress of reforms is interrupted.

Another decisive role in shaping reforms' fate plays effective internal and external communication. In both countries the pronounced goals of the tax authority's

communication strategy have been two-fold: first informing about reform plans and second changing the attitude among tax officials and taxpayers. Yet, again, the approach chosen by Indonesia and the Philippines has been distinct. Indonesia invested larger amounts of energy and money in its communication strategy than the Philippines. Moreover, the information contained in communications both inside and outside the tax authority has been more reliable. “Carrots and sticks” policies introduced in the Philippines were of little meaning, sanctions for inappropriate behaviour existed on paper only; in practise they were never executed. In contrast, in Indonesia the general perception had been that consequences might be real; hence it would be necessary to be more careful in what was doing. The risk-calculation in regard of inappropriate behaviour began to change. This had a positive impact on reform implementation.

External communication has also been more effective in Indonesia than the Philippines. While the BIR went out on a “tax drive” only once a year, the DGT made many more efforts to prove Indonesians of their existence, mandate, mission and vision. The DGT’s communication strategy was also more coherent and more recognisable than the BIR’s. The BIR’s campaign logos and mottos changed every year; the DGT also had some changes, yet for several years in a row it relied on its mascot, Kojib the honey bee and simple tag lines. Indonesia’s citizens gained the impression that the DGT was in a state of change. Philippine citizens on the other hand were less confronted with the BIR.

The evidence gained from the two case studies suggests that the likelihood of tax administration reforms is restricted by the institutional pre-configuration and influenced by mainly two variables: the degree of power concentration, referring to the degree of economic elite capture of politics and bureaucracy, and the strength of change management in the reform process. Path dependence implies that the system in place by and large is resistant to change. Yet, agency can overcome institutional constraints and hence lead to change. The case studies point out the relevance of agency-related factors.

Strong power concentration and weak change management, as the Philippine case indicates, is very likely to result in continuity. By contrast, as the Indonesian case indicates, strong change management within an environment characterized by intermediate power concentration may promote transformation and even change when all conditions are right. The study’s initial research hypotheses are therewith supported.

The different combinations of power concentration and change management and the respective expected theoretical outcomes of tax administration reform processes, given comparable conditions of reform, are presented in Table 6.2.

TABLE 6.2: *The Likelihood of Reforms – A Theoretical Model*

		Power Concentration		
		weak	intermediate	strong
Change Management	weak	continuity/ transformation	continuity	continuity
	intermediate	change	transformation	continuity
	strong	change	transformation/ change	transformation

<sup>a</sup> The findings from the comparative analysis of the Indonesian and Philippine case studies that the characteristics of power concentration and change management are highly significant in explaining the outcome of tax administration reforms should not lead to the conclusion that other factors are irrelevant. Reforms are highly complex and highly context-dependent. The influence of factors may change in different places and at different times.

Source: Author's compilation.

## 6.2 Implications for Scholarship and Policy

Looking from a macroperspective, the study's findings have implications for scholarship and practise. Some relevant lessons about taxation and tax reforms in developing countries can be learnt.

The study has fostered the literature strand on the political economy of reforms in developing countries. As discussed above, its findings support the argument of institutional inertia as an explanation for inadequate performance of tax authorities and slow reforms. Yet, even more they point out the importance of agency in shaping the tax system and the reform process. The findings add nuance to the understanding of the structure and agency relationship. Institutions shape, yet they do not determine outcome. Agents make decisions and choose directions. Both in turn influence each other. The implication is that in research at least as much attention needs to be given to the analysis of agency-related factors as to the analysis of formal and informal institutions. An understanding of power relations is crucial to understand institutions

and institutional change. There are strong arguments to follow this approach in related research projects seeking to understand the development of economic institutions.

Further, the study provided evidence that corruption may be more a secondary than a primary problem. Corruption appears to be more the outcome of opportunities created by vested interests than something that has emerged by itself. Hence, studies investigating corruption and its impacts seem well advised to search for corruption's underpinnings. The concept of neopatrimonialism with its particular emphasis on studying the relations between formal and informal institutions and actors has proven highly valuable in this regard. It may well be considered in further studies.

Also, the study's findings indicate a linkage between taxation and state governance. Thus, researchers working on good governance assessments may consider going beyond expenditure variables and including variables from the revenue side in the future.

For policy, the study's findings offer some general implications. Foremost, the study emphasises the need for political economy analyses prior to the development of technical solutions. Reforms are complex and highly-context dependent. While many challenges in tax administration are shared by the majority of developing and emerging economies, past experience has shown that the solutions that work are not. There is no best practise solution that can transform any tax administration in an effective, efficient, equitable, and impartial organisation. Solutions need to be tailored to the particular country's conditions to have the chance of being adopted and transforming the administration.

The study strongly suggests that it is important to identify and support reform-oriented individuals, train them and assist in building coalitions of support. Without sincere ownership and leadership real transformation let alone change seems unlikely to occur. International donors can assist in the improvement of tax systems, yet they are unable to push through meaningful reforms without the partner country's sincere willingness to reform. If reforms occur, they may be only gimmick to please international conditionalities.

In this regard, strong change management has been identified as highly significant. A coherent strategy, consistency and a longer-term perspective seem necessary ingredients of a successful reform process. Resistance needs to be contained and support fostered. All stakeholders need to be informed about the planned reforms, the potential benefits they carry and the way forward. Involving the general public holds the potential to induce public pressure which in turn might mitigate elite opposition. Also, engaging more in elite dialogue on the legitimation and benefits of tax reforms might ultimately lead to gains. Even if these were small, they would benefit the state budget.

The creation of reform space is crucial. Hence, there are strong arguments to direct substantial resources into internal and external change management activities. Technical adjustments, such as the computerisation of the tax administration and automation of processes alone will not lead to the necessary change desired. It is actors who can change institutions. Change and sustainability requires human backing and support.

For the desired characteristics of reforms two issues deserving consideration have been identified. First, incremental reforms starting with easily reachable yet visible activities seem more practicable in environments where initial resistance to reforms is strong than instant comprehensive changeover reform plans. At the early stage, it might be advisable to prefer politically feasible reforms over economically desirable reforms. Second, tax reforms need to be seen in the broader context. As the study has pointed out institutions outside the tax administration, such as the general public administration system, the judiciary, and parliament might impede tax administration reforms progress. Hence, reform of the institutional underpinnings/underlying structures might be as crucial as reforms of other institutions. In this regard, increased coordination and cooperation is necessary.

### **6.3 Further Research**

The interdisciplinary character of this study allows for broad connectivity. Of necessity, this study has focused on some questions to the exclusion of others. With its limited domain—taxation—and time-frame analysed—focusing on the years 2002 until 2010—this study leaves many opportunities for further research. In the following, selected research avenues are suggested.

By the time this study was finalized, reforms were still ongoing, thus their impact could not be determined for certain. Thus revisiting the status of the tax administration reforms in several years' time might be a fruitful endeavour. Related, is the issue of reform effects lagging in time. International finance institutions and development agencies acknowledged the low success rate of civil service and administrative reforms worldwide. What has worked well at a certain point in time, might be stopped or even reversed at a later point in time. Similarly, if reforms do not move today, under circumstances changed they may tomorrow. Both case studies also indicated that the reforms are far from a linear progression. It might be interesting to see how taxation in Indonesia and the Philippines develops and whether the developments observed remain explainable by the factors identified by this study.

Future studies may also extend analysis from the national level to analyses of taxation at the sub-national level. Two issues are of particular interest. First, the interrelationship between national and sub-national decision-making, and second, the comparison of leadership decisions and developments in taxation in different local entities. Worth exploring is the question of whether certain characteristics of local elites encountered lead to distinctly different processes and outcomes.

More generally, this study's empirical data may in the future be used for systematic medium and large- N studies of why developing countries do not collect more revenues, why and how reforms are introduced, and why some countries are more successful in introducing change than others. So far, a comprehensive reliable data-set on tax administrations and reform efforts in transition and developing countries is missing. Better evidence could help us in better understanding what we encounter and thus in

better designing future reform activities. This study has pointed out a number of features and indicators that are worth considering. It has also indicated where further efforts are needed to improve data quality and availability.

The study has highlighted the implications of politics in shaping economic outcomes. Research on this issue should be deepened in order to be able to draw more general conclusions of how and why successful reforms occur. Further studies are needed. Particularly promising are studies at the intersection of political science, economics, public administration and economic history. So far, this territory has been relatively unexplored; this study has been an early contribution towards expounding this research agenda.

## 7 Appendix I

### 7.1 Tenure of Office in Finance, Indonesia and the Philippines

#### 7.1.1 Indonesia: Presidents, Coordinating Ministers of Economic Affairs, Finance Ministers and Directors General of Taxes (1968-2011)

Year Election Year	President	Coordinating Minister of Economic Affairs	Finance Minister	Director General of Taxes
1968	Soeharto	-	Ali Wardhana	Soeyoedno
1969				Brotodihardjo
1970				Sutadi Sukarya
1971				
1972				
1973				
1974				
1975				
1976				
1977				
1978				
1979		Widjojo Nitisastro		
1980				
1981				Salamun A.T.
1982				
1983		Widijojo Nitisastro Ali Wardana		
1984		Ali Wardana	Radius Prawiro	
1985				
1986				
1987				
1988	Ali Wardana Radius Prawiro		Mar’ie Muhammad	
1989	Radius Prawiro	Joannes Baptista Sumarlin and Nasruddin Sumintapura		
1990				
1991				
1992				
1993	Radius Prawiro Saleh Afiff		Fuad Bawazier	
1994	Saleh Afiff	Mar’ie Muhammad		
1995				
1996				
1997				
1998	Soeharto B.J. Habibie	Ginandjar Kartasasmita	Mari’ie Muhammed Fuad Bawazier	Anshari Ritonga
1999	B.J. Habibie Abdurrahman Wahid	Ginandjar Kartasasmita Kwik Kian Gie	Bambang Subianto	
2000	Abdurrahman Wahid	Rizal Ramli	Bambang Sudibyo	Machfud Sidik



2001	Abdurrahman Wahid Megawati	Rizal Ramli Dorodjatun Kuntjoro-Jakti	Prijadi Praptosuhardjo Rizal Ramli	Hadi Purnomo
2002	Megawati	Dorodjatun Kuntjoro-Jakti	Boediono	
2003				
2004	Megawati Susilo Bambang Yudhoyono	Dorodjatun Kuntjoro-Jakti Aburizal Bakrie		
2005	Susilo Bambang Yudhoyono	Aburizal Bakrie	Jusuf Anwar	
2006		Boediono	Sri Mulyani Indrawati	Hadi Purnomo Darmin Nasution
2007				Darmin Nasution
2008		Boediono Sri Mulyani Indrawati		Darmin Nasution Mochamad Tjiptardjo
2009		Sri Mulyani Indrawati Hatta Radjasa		
2010		Hatta Radjasa	Sri Mulyani Indrawati Agus Martowardojo	Mochamad Tjiptardjo
2011			Agus Martowardojo	Fuad Rahmany

*Sources:* Author's compilation based on data from the State Secretariat, Ministry of Finance, and the Directorate General of Taxes.

### 7.1.2 The Philippines: Presidents, Secretaries of Finance, Undersecretaries for Revenue, Operations, and Legal Affairs, Commissioners of Internal Revenue (1965-2011)

Year Election Year	President	Secretary of Finance	Undersecretary for Revenue, Operations and Legal Affairs	Commissioner of Internal Revenue
1965	Ferdinand E. Marcos	Rufino Hechanova		Misael Vera
1966		Eduardo Romualdez		
1967				
1968				
1969				
1970		Eduardo Romualdez Cesar Virata		
1971		Cesar Virata		
1972	Ferdinand E. Marcos			
1973				
1974				
1975				Efren Plana
1976				
1977				
1978				
1979				
1980				
1981				
1982				
1983				
1984				
1985				

1986	Ferdinand E. Marcos Corazon Cojuangco-Aquino	Cesar Virata Jaime V. Ongpin		Bienvenido A. Tan, Jr
1987	Corazon Cojuangco-Aquino	Jaime V. Ongpin Vicente Jayme		Bienvenido A. Tan, Jr Jose U. Ong
1988		Vicente Jayme		Jose U. Ong
1989		Jesus Estanislao		Liwayway Vinzons-Chato
1990				
1991		Jesus Estanislao		
1992		Ramon del Rosario		
1993	Corazon Cojuangco-Aquino Fidel V. Ramos	Ramon del Rosario Ernest C. Leung		
1994	Fidel V. Ramos	Ernest C. Leung Roberto de Ocampo		Beethoven L. Rualo
1995		Roberto de Ocampo		
1996		Roberto de Ocampo		
1997		Salvador Enriquez		
1998		Edgardo B. Espiritu		
1999	Fidel V. Ramos Joseph Ejercito Estrada	Edgardo B. Espiritu		Dakila B. Fonancier
2000	Joseph Ejercito Estrada	Jose T. Pardo	Cornelo Gison	
2001		Alberto G. Romulo Jose Isidro N. Camacho		Rene'G. Banez
2002	Joseph Ejercito Estrada Gloria Macapagal-Arroyo	Jose Isidro N. Camacho	Cornelio Gison Grace Pulido Tan	Guillermo L. Parayno, Jr.
2003	Gloria Macapagal-Arroyo	Jose Isidro N. Camacho Juanita D. Amatang	Grace Pulido Tan	Jose Mario D. Bunag
2004		Juanita D. Amatang		
2005		Juanita D. Amatang Cesar V. Purisima Margarito B. Teves	Grace Pulido Tan Emmanuel Bonoan	
2006		Margarito B. Teves	Emmanuel Bonoan Gaudencio Mendoza	
2007			Gaudencio Mendoza	Lilian B. Hefti
2008			Gaudencio Mendoza Estela Sales	Sixto S. Esquivias IV
2009			Estela Sales	
2010	Gloria Macapagal-Arroyo  Benigno "Noynoy" Aquino	Margarito B. Teves  Cesar V. Purisima		Joel L. Tan Torres  Kim S. Jacinto-Henares

2011	Benigno "Noynoy" Aquino	Cesar V. Purisima		Kim S. Jacinto-Henares
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*Sources:* Author's compilation based on data from the Office of the President, Department of Finance, and the Bureau of Internal Revenue.

## 7.2 (Alleged) High Profile Corruption Cases, Indonesia (2010-2012)

Verdict	Name, Age at Sentence, Position	Case
2010	Eddi Setiadi (56 years)  2001: Head of Tax Audit and Investigation Office Bandung I	<p>Prosecutors alleged that Setiadi had lead the manipulation of provincial government-owned West Java Bank's (PT Bank Jabar, now called Bank BJB) tax returns for 2001 and 2002 for a "consultation fee", i.e. kickback, of Rp 2.55 billion in cash between 2002 and 2004. Allegedly, in 2001, the bank was supposed to have paid Rp 129.3 billion, this was initially slashed to Rp 74 billion and finally to Rp 5 billion. In 2002, the bank had to pay Rp 51.8 billion, which was reduced first to Rp 25.6 billion and then to 7.3 billion. Allegedly, Setiadi took Rp 565 million from the kickback and gave the remainder to his subordinate tax officers (see below). Setiadi is also said to have received annual payoffs for lowering tax obligations.</p> <p>Prosecutors recommended 12 years imprisonment.</p> <p>Sentenced to six-and-a-half years imprisonment for committing corruption collectively as charged in the primary indictment and a fine of Rp 200 million by the Anti-Corruption Court in 07/10.</p>
2011	Dedy Suwardi (59 years)  2001: Supervisor of tax inspector teams at Tax Audit and Investigation Office Bandung I	<p>Indicted for conspiracy with his superior Eddi Setiadi (see above) and his colleagues Roy Yuliandri, Mohammad Yazid, and Dien Prajana Mulya (see below) in manipulating the tax returns of West Java Bank. Suwardi allegedly also passed Rp 150 million to the Head of the Bank's Accounting Division Herry Achmad Buchori.</p> <p>Prosecutors recommended 7 years imprisonment and a fine of Rp 200 million.</p> <p>Sentenced to 6 years imprisonment and a fine of Rp 200 million by the Anti-Corruption Court in 01/2011.</p>
2011	Roy Yuliandri (41 years)  Mohammad Yazid (39 years)  Dien Prajana Mulya (39 years)  2001: All tax auditors at Tax Audit and Investigation Office Bandung I	<p>Indicted for conspiracy with their superiors Dedy Suwardi and Eddi Setiadi (see above) in manipulating the tax returns of West Java Bank.</p> <p>Yuliandiri, the head of the tax inspectors team, was accused of having received a share of Rp 500 million, Yazid, team member, of Rp 475 million, and Prajana Mulya, also team member, of Rp 310 million of the bribe.</p> <p>Prosecutors recommended 7.5 years imprisonment and a fine of Rp 200 million each.</p> <p>Yuliandiri was sentenced to three years imprisonment and a fine of Rp 150 million, Yazid to two years and Rp 100 million, and Prajana Mulya to one-and-a-half years and Rp 100 million by the Anti-Corruption Court in 01/2011.</p>
2011	Bambung Heru Ismiarso  2007: Director of Tax Objections, DGT headquarters	<p>Tried over tax evasion allegations involving PT Surya Alam Tunggal, which reportedly caused state losses of around Rp 571 million.</p> <p>Sentenced to two years imprisonment and a Rp 100 million fine for conspiracy with his subordinate Gayus Tambunan by the Anti-Corruption Court in 11/2011.</p>

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		*Relatedly tried and sentenced, Gayus superiors: Maruli Pandapotan Manurung (2.5 years, Rp 50 million), Humala Setia Leonardo Napitulu (2 years, Rp 50 million), and Johnny Marihot Tobing (status unclear)
2012	Dhana Widyatmika (38 years)	PPATK reported that Widyatmika had Rp 28 billion and US\$ 250 thousand in his bank accounts. Alleged of accepting kickbacks. Prosecutors sought 12 years imprisonment and Rp 1 billion fine.
	2011: Account Representative, Large Taxpayers Office II	Sentenced to 7 years imprisonment and Rp 300 million fine for taking bribes and money laundering by the Anti-Corruption Court in 11/2012.
2012	Tommy Hindratno	Arrested red-handed by the KPK allegedly accepting bribes worth Rp 280 million from a private business accountant for a tax refund fraud. Allegedly, the fraud allowed a local investment firm to reclaim Rp 3.4 billion in what it claimed to be overpaid taxes. Prosecutors sought 5 years imprisonment and a Rp 50 million fine.
	2012: Head of Supervision and Consultation Section; Sidoarjo District Tax Office, East Java	Sentenced to 3.5 years' imprisonment and Rp 100 million fine for taking bribes by the Anti-Corruption Court in 02/2013.
2012	Anggrah Suryo	Arrested red-handed by the KPK allegedly accepting bribes worth Rp 300 million from a private employee in exchange for lowering the taxes of her company in 07/2012.
	2012: Head of Bogor Tax Office	

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<sup>a</sup> The cases of Gayus Tambunan and Bahasyim Assifie are presented in Table 4.7.

<sup>b</sup> The graft convicts are reportedly imprisoned in a special prison, Sukamiskin Penitentiary, located in Bandung, West Java.

Sources: JG 27.02.2010; 07.01.2011; 02.02.2011; 27.05.2011; 05.11.2011; JP 19.08.2010; 15.11.2010; 10.11.2012 ; 19.02.2013; T 02.05.2012 ; 06.07.2012 ; 28.12.2012 ; Mahkamah Agung (2011a; b; c)

## 8 Appendix II

### 8.1 Interviews and Focus Group Discussions in Indonesia

Interviews and Focus Group Discussions in Indonesia were conducted between April 9<sup>th</sup>, 2009 and June 21<sup>st</sup>, 2009. All interviews and FGDs were conducted within the Special Capital City District of Jakarta. All interviewees and FGD participants occupied senior positions within their organisation/department. For confidentiality reasons, their personal data is not disclosed.

#### **Tax Officials, Management and Middle Level, Directorate General of Taxes**

Secretariat General.

Directorate of Tax Potential, Compliance and Revenue, Section for Tax Potential of the Trade Sector.

Directorate of Transformation of Business Processes, Sub-Directorate of Tax Service Development.

Directorate of Transformation of Business Processes, Section for Counselling Development.

Directorate of Transformation of Business Processes, Section of Tax Service Development.

Directorate of Tax Audit and Collection, Sub-Division for Claims.

Directorate of Tax Audit and Collection, Sub-Directorate of Collection and Audit.

Directorate of Tax Audit and Collection, Section for Tax Collection, Strategy, and Support.

Directorate of Tax Potential, Compliance and Revenue, Section for Tax Potential of the Industrial Sector.

Division for Organization and Procedures.

Sub-Directorate of Tax Counselling, Service, and Public Relations.

Regional Office DGT Central Jakarta.

District Tax Service Office, Tanah Abang, DKI Jakarta.

National Tax Court.

#### **Other Government Officials**

Corruption Eradication Commission, Management.

Department of Finance, Office of Public Relations.

Department of Finance, Office for the Development of Human Resources.

Financial Transaction Reports and Analysis Center, Management.

Supreme Audit Board, Audit Department State Finances VI.

#### **Business Representatives**

Chamber of Commerce and Industry, East Jakarta.

European Chamber of Commerce.

Indonesian Taxpayers' Association.

Indonesian Workers Association.

Medium-Sized Business.

Public Limited Company.

#### **Civil Society Representatives**

Indonesia Corruption Watch, Management.

Indonesia Corruption Watch, Public Service Provision Division.

National Media Outlet, Research and Development Office.  
 Partnership/Kemitraan, Public Service Governance Cluster.  
 Transparency International Indonesia, Management  
 Transparency International Indonesia, Public Service Division.

### **Politicians**

Member of Parliament, PAN, Commission for Governance, Working Group on Public Service Law.  
 Member of Parliament, PAN, Commission XI for Financial Affairs.  
 Member of Parliament, PDI-P, DPR Honors Board.  
 Member of Parliament, former Minister for State Administration Reform.  
 Member of Parliament, former Coordinating-Minister for Economics, Finance and Security.

### **Social Scientists**

Professor of Economics, University of Indonesia.  
 Professor of Law, University of Indonesia.  
 Professor of Public Administration, University of Indonesia.  
 Professor of Public Policy, Gadjah Mada University.

### **International Organisation Representatives**

CIM, Advisor Capacity Building for Public Sector Organisations.  
 Friedrich-Naumann-Foundation, Indonesia Country Office.  
 GIZ, Indonesia Country Office, Support for Good Governance Programme.  
 International Monetary Fund, Resident Senior Tax Administration Advisor.  
 World Bank, Resident Public Administration Specialist/System's Engineer.  
 World Bank, Headquarters, Tax Administration Reform Programmes Asia.  
 World Bank, Indonesia Country Office, Lead Public Sector Specialist.

### **Focus Group Discussion: Tax Administration**

Secretariat General.  
 Human Resources.  
 Sub-Directorate of Computer Application and Development.  
 Sub-Directorate of Human Resources Competency and Capacity Development.  
 Sub-Directorate of Organization Transformation.  
 District Tax Service Office, Kebayoran Lama, DKI Jakarta.

### **Focus Group Discussion: Business**

Chamber of Commerce and Industry Jakarta.  
 Chamber of Commerce and Industry Jakarta.  
 Entrepreneurs Association Indonesia.

## 8.2 Interviews and Focus Group Discussions in the Philippines

Interviews and Focus Group Discussions in the Philippines were conducted between February 2<sup>nd</sup>, 2009 and April 8<sup>th</sup>, 2009. All interviews and FGDs were conducted within National Capital Region of Metro Manila. All interviewees and FGD participants occupied senior positions within their organisation/department. For confidentiality reasons, their personal data is not disclosed.

### **Tax Officials, Management and Middle Level, Bureau of Internal Revenue**

Former Commissioner of Internal Revenue.

Former Deputy-Commissioner.

Former Deputy-Commissioner.

Operations Group.

Tax Administration Reform Group.

Research Division.

Public Relations Division.

### **Other Government Officials**

Civil Service Commission.

Department of Finance.

National Economic Development Authority.

National Tax Research Center.

### **Business Representatives**

Asian Management Association.

Makati Business Club.

Philippine Chamber of Commerce.

PricewaterhouseCoopers Philippines.

Public Limited Company.

### **Civil Society Representatives**

Action for Economic Reform.

National Media Outlet, Journalist.

Social Watch Philippines.

Social Weather Stations.

Synergeia.

Transparency and Accountability Network, Transparency International Philippines.

### **Politicians**

Member of 1987 Constitutional Commission.

Member of Parliament, Congress Ways and Means Commission.

Member of Parliament, Coordinator Freedom of Information Bill.

### **Social Scientists**

Professor of Economics, University of the Asia and the Pacific.

Professor of Law, University of the Philippines.

Professor of Political Science, De La Salle University.



Professor of Political Science, University of the Philippines.

Professor of Political Science, University of the Philippines.

Professor of Political Science, University of the Philippines.

Associate Professor of Political Science, De La Salle University.

#### **International Organisation Representatives**

Asian Development Bank, Governance and Capacity Development Specialist.

Friedrich-Ebert-Foundation, Philippines Country Office.

Friedrich-Naumann-Foundation, Philippines Country Office.

German Embassy, Political Affairs Officer.

GIZ, Philippines Country Office, iTAX-Integrated Tax Administration System Project.

International Finance Corporation, Tax Administration Reform Specialist.

Philippines-Australia Partnership for Economic Governance Reform.

USAID United States Agency for International Development, Governance Specialist.

USAID United States Agency for International Development/MCC, Tax Administration Specialist.

World Bank, Philippines Country Office, Senior Economist.

#### **Focus Group Discussion: Tax Administration**

Collection Programmes Division.

Internal Audit Division.

Large Taxpayers Assistance Division.

#### **Focus Group Discussion: Business**

Small- to mid-sized businesses.

### 8.3 Guidelines for Semi-Structured Interviews

The following questions served as general guideline for the formal face-to-face expert interviews conducted for this study in Indonesia and the Philippines. Based on these questions, separate guidelines adjusted to the context were employed to each respondent group. Interviews were semi-structured; in addition to the prepared questions relevant probing questions were asked and interesting hints followed. Depending on the interviewee, interviews were conducted either in English, Indonesian, or German.

1) Opening

Personal Experience

What is your background? What motivated you to choose your profession?

What is your experience with the tax administration/public administration?

What kind of positions have you worked in? What are your current duties and responsibilities?

2) Human Resource Management

Recruitment

What is most important to get a job at the tax administration (qualifications, merit, personal connections, financial means)?

Who are the main actors involved in the recruitment process? How would you describe the influence each actor/group has?

How would you rate the qualification level of staff in tax administration?

Promotion

What is most important to climb up the ladder within the tax administration?

Personally, are you satisfied with your progress, career?

Are personal connections (to superiors, to politicians) helpful?

Mutation/Transfer

How would you describe the decision-making process on placements and transfers?

Are there any particular positions which are very sought after? If yes, why?

Are there any particular positions tax officials dislike? If yes, why?

Management

How often does the management of the tax administration change?

If the management changes frequently, why?

What is the impact of management change on the tax administration?

How large is the share of political appointments in the tax administration, in public service?

3) Business Operations

Knowledge/Transparency

How do you determine who has to pay taxes?

How do you determine outstanding taxes?

Do you know in advance how much taxes you have to pay?

How do you evaluate the quality of taxation rules and regulations?

Is every taxpayer treated in the same way? If not, why?

If I were a rich and powerful business person, would I have the chance to influence my tax assessments? Would it be possible to hide my fortune?

## Working conditions

Are there any attempts of external influence/interference? If yes, how, how often, and in what matters?

Can a decision taken by a civil servant be revoked by a politician?

Are there any attempts of influencing/interfering from business interests? If yes, how, how often and in what matters? Is it possible to bargain?

Are there certain people who are “untouchable”?

4) Administrative Accountability

## Extend of corruption and collusion

How common are cases of corruption or external intervention with the day-to-day operations of the tax administration?

## Accountability mechanisms

What are the internal/external mechanisms to protect accountability at the tax administration? How effective are these mechanisms?

5) Tax Administration Reforms

## Performance

How would you characterise the performance of the tax administration? How efficient is it compared to other public sector departments?

## Transformation and reform

Did the tax administration, the civil service of earlier times look different than the tax administration, the civil service system of today? What caused the changes?

How would you describe the most recent reform attempts?

Who are the main actors involved in the reform process? How were decisions made to follow the specific measures? Why were these measures chosen?

How would you describe the positions of the main stakeholders? Who drives, who supports, who blocks reforms? Are there particular factors which push/hamper reforms?

How would you describe the relation between international and domestic actors?

How would you describe the role of civil society in tax administration reforms?

6) Political Level (if applicable)

## Lines of authority

How is the relationship between politics (the government) and tax administration?

## High-level appointments

What are the most important criteria to get and to maintain a position in the ministerial cabinet?

Are any positions, apart from the president's, particularly sought after by politicians? Which? Why?

## Management of public resources

How prudent is the management of public resources?

How common is misconduct among politicians?

7) Prospects

## Evaluation and outlook

How do you evaluate the progress/success of the reforms?

How do you think the public evaluates your work? Is the assessment fair?

What are the biggest challenges for tax administration in the future?

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Cash Surplus/Deficit (% of GDP)

Central Government Debt, Total (% of GDP)

GDP (current US\$)

Net ODA Received (current US\$)

Net Official Development Assistance and Official Aid Received (current US\$)

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### 9.1.5 Indonesian Newspapers and Magazines

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27.07.2010: Indonesian Tax Official Gets 6.5 Years in Jail for Corruption.

21.10.2010: KPK to Shine Light on BPK Chief's Suspicious Fortune.

07.01.2011: Gayus Tambunan Admits to Macau, Kuala Lumpur and Singapore Travel.

02.02.2011: Tax Man Bahasyim Gets 10 Years for Money Laundering.

27.05.2011: Six-Year Prison Term Sought for Warden in Gayus Scandal.

18.08.2011: Misbakhun Released From Prison.

27.08.2011: Legislature's 'Sinners' Are Still Getting Government Paychecks.

05.11.2011: Ex-Boss Jailed for Abetting Gayus.

10.12.2012: KPK to Force Civil Servants to Explain Assets.

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18.02.2005: "I Don't Care" About Graft Report: Minister.

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28.04.2009a: Special Report: Mulyani's iconic reform on weak footing.

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12.09.2009: Brokers May Act to Stifle Bailout Inquiry.

16.12.2009: BPK May Become Mired in Political Fray.

06.04.2010a: Auditing Tax Officials' Assets

06.04.2010b: Commentary: Mulyani Needs Whistle-Blower Hotlines for Early Warning.

- 19.04.2010: Editorial: The Filthy Rich Tax Officials.  
08.05.2010: Legislators' Suspect Tax Officials Involvement.  
12.05.2010: Eradicating Tax Mafia: No More Toothless Tigers.  
19.08.2010: Gayus Says He Paid Judge \$40.000 for Acquittal.  
15.11.2010: Warden Says Gayus Had 68 Times Since July.  
22.11.2010: When It Comes to Big Boys' Tax Probes, None Can Stand the Heat.  
13.04.2011: Dynasties in the Making.  
20.10.2011: Golkar Vows to Give Agus a 'Hard Time'.  
21.10.2011: RI among Highest Contributors to Growth.  
10.11.2012: One Judge Dissents Dhana is Convicted of Corruption.  
19.02.2013: National Scene: Former Taxman Gets 3.5 Years for Bribery.

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26.08.2009: 8 Juta Wajib Pajak Baru Berpenghasilan Rendah [8 Million New Taxpayers Having Low Income].  
16.02.2010: Perselingkuhan Bisnis – Politik [Cheating Business – Politics].  
14.05.2010: Ditjen Pajak Bukan Lagi ATM [DG Taxes No Longer Cashpoint].  
04.06.2010: Golkar: Setgab Setuju Dana Rp 15 m [Golkar: Joint Secretariat agreed on Rp 15 billion fund].  
30.06.2010: Masalah SDM Ditjen Pajak Serius [DGT's Human Resources Problem is Serious].  
05.08.2010: Pegawai Pajak Telat, Potongan Rp 400.000 [Tax Official Late, Deduction Rp 400.000].  
29.10.2010: Ditjen Pajak Rekrut 1.750 Pegawai Baru [DGT Recruits 1.750 New Employees].

#### Koran Tempo (KT)

- 08.06.2007: Penertiban Rekening Liar Pemerintah [Curbing Unauthorized Government Accounts].  
02.05.2012: Graft Convict Bahasyim Returns Rp 67B to State.  
06.07.2012: Gayus Jail Term Over Third Corruption Case Increased to 8 Years.  
28.12.2012: Koruptor Dijamin Lebih “Sengsara” di Sukamiskin [Corruptors Promised to “Suffer More” in Sukamiskin].

#### Majalah Tempo (MT)

- 30.12.1972: Antara Si Bujang Dan Si Jutawan [Between Servant and Millionaire].  
18.08.1973: Dari Pintu ke Tempok [From Door to Masonry Wall].  
05.10.1974: Halo, Mantri Pajak [Hello, Tax Official].  
18.02.2002: Terjebak di Keranjang Sampah [Trapped in the Waste Basket].  
29.11.2004: Paksa Badan Entah di Mana [Physical Confinement Nowhere].  
13.06.2005a: Direktur Jenderal Pajak Hadi Purnomo: Emang Saya Dukun? [Director General of Taxes Hadi Purnomo: Am I a Shaman?].  
13.06.2005b: Golongan Bawah, Gaya Mewah [Low-Ranking, Luxury Lifestyle].  
28.11.2005: Bisnis dan Kuasa Pejabat [Business and Official Power].  
11.06.2007: Haram Nego di Bawah Meja [It Is Forbidden to Negotiate Below the Table].  
03.08.2009: Beban Berat Pilot Baru [Heavy Load for the New Pilot].  
14.12.2009: Sengketa Baru, Seteru Lama [New Dispute, Old Feud].  
07.06.2010: Rame-Rame Menggempur Tjiptardjo [Collectively Attacking Tjiptardjo].  
21.06.2010a: Jejaring Ahli Tata Buku [Network of Accountants].  
21.06.2010b: Laporan Utama: Tafsir Hibah Hadi Poernomo [Cover Story: Interpreting Hadi Poernomo's Grants].

**Rakyat Merdeka (RM)**

17.02.2010: 85 Persen Birokrat Bermoral Buruk dan Tidak Kompeten [85 Percent of Bureaucrats of Low Morale and Incompetent].

**Riau Pos (RP)**

06.06.2009: Tahun Anggaran 2009, Seleksi Administrasi Seluruh Honorer Diangkat PNS [Budgetary Fiscal Year 2009, Administrative Selection All Honorarium Staff to be Appointed Civil Servants].

**Tribun News (TN)**

01.10.2010: 40 Ribu Anak KidZania Sudah Miliki NPWP [Already 40.000 KidZania Kids Have a Tax Identification Number].

**VivaNews (VN)**

22.12.2008: BPK: Rekening Liar Juga Banyak di Depkeu [BPK: Many Illicit Accounts also with the Department of Finance].

01.04.2010: 20 Ribu Facebookers Siap Boikot Bayar Pajak [Twenty-thousand Facebookers Prepared to Boycott Paying Taxes].

### **9.1.6 Philippine Newspapers and Magazines**

**ABS-CBN**

22.10.2008: New BIR Chief Reportedly Backed by Enrile, Recto.

12.02.2009: From Accuser to Accused: World Bank Defends Investigations.

10.11.2009: Former BIR Chief Forcibly Ousted.

09.02.2011: Customs Collector Faces Tax Evasion Raps.

04.07.2011: Gov't Struck Deal with Gutierrez over Resignation.

**Balita (B)**

11.06.2012: CA Orders Reinstatement of Dismissed BIR Official.

**Business Mirror (BM)**

10.04.2011, Briones, Leonor: Opinion: Making Taxes as Permanent as Death.

26.02.2012: DOF Not Ready for Lateral Attrition Law.

20.12.2012: Aquino: 'Sin tax' law early Christmas gift to Pinoys.

**Business World (BW)**

03.08.1999: Roll over Beethoven.

09.02.2009: Fortune Tobacco Presses Supreme Court to Begin Trial vs. Former Tax Commissioner.

10.06.2012, Sta Ana III, Filomeno: Opinion: Passage of the 'Sin' Tax Bill.

**GMA News (GMAN)**

12.08.2006: Ombudsman Wants 3 Finance Officials Sued for Ill-gotten Wealth.

11.12.2007: Survey: Arroyo Most Corrupt, Aquino Cleanest of 5 Prexies.

03.03.2008: Customs Staff Asks SC to Stop Lateral Attrition Act.

22.07.2010: Ex-Rep. Hontiveros Leads 2nd Impeachment vs. Gutierrez.

24.05.2011: Sandiganbayan Junks Graft Case vs. BIR Official.

27.07.2011: Millionaire Congressmen Represent Poor Constituents.

04.05.2012: Convicted Tax Evader Tries but Fails to Flee PHL – DOJ.

## Malaya Business Insight (MBI)

- 05.10.2009: What's in BIR (LTS) Unit that Attracts Miriam & Husband Jun Santiago?  
02.07.2010: BIR Kicks Out PARE.

## Manila Bulletin (MB)

- 22.11.2003: GMA Respects Camacho Resignation; Amatong is Officer-In-Charge.  
18.08.2005: SC Acquits Former BIR Commissioner Tan of Graft Charges.  
11.10.2008: BIR Chief Resigns, Citing Health Reasons.  
03.11.2009: Tan Torres Takes Over BIR.  
03.01.2011: No More Hired Help at BIR.  
17.02.2011: BIR Chief Stops Practise of 'Switching' Tax.  
23.02.2011: Turf War Turns into Legal Battle.

## Manila Standard (MS)

- 28.05.2009: Santiago is Named Deputy amid BIR Chief's Grumbles.  
29.05.2009: Whoops, Malacañang Misspoke on BIR Appointment.  
23.07.2009: Demoted BIR Exec Appointed in Palace List.

## Manila Times (MT)

- 28.04.2003: Special Report: A Very Thin Line between Multilevel Marketing and Pyramide Schemes.  
28.02.2008: Teves in Rough Confirmation.  
04.12.2008: From the Sidelines: DOLE Turns 75.  
04.11.2011: Opinion: Politics: Anathema to Antique's Growth.  
27.07.2011: 'Vast Sums of Money' Doom Noted Tax Lawyer.

## Newsbreak (N)

- 04.04.2001a: The Wrong Tan.  
04.04.2001b: Why the Big Fish Never Get Caught.  
29.08.2001: Rough Sailing in the Senate.  
14.10.2002: The World According to Parayno.  
05.12.2004: A Taxing Experience.  
20.06.2005: "No Compromise".  
20.06.2005: It's Payback Time.  
18.11.2006: What's Boggling Down the DOF?  
11.02.2007: What Friends Are For: The First Gentleman Expands his Old Circle of Ten.

## Philippine Center for Investigative Journalism (PCIJ)

- 28.-30.09.1998: Ombudsman Cases "Just Lie There and Die There".  
January-March 1999: Into the Light: Demonized by His Foes, Lucio Tan is Hailed a Hero by the New Administration.  
April-June 1999: Lord of the Press.  
03.-04.10.2001: Legislators Protect Themselves and Their Friends.  
12.-14.05.2003: BIR Officials Amass Unexplained Wealth.  
06.-07.09.2004: Pork is a Political, Not a Developmental Tool.  
28.-29.07.2005: Shame and Scandal in the Family, The Queens Gambit.  
14.08.2006: Incentives for the Rich, Harm the Poor.  
01.03.2007: New Political Dynasties. Still a Family Affair.  
30.03.2007: New Political Dynasties. Powershift Looms in Cebu Politics.  
25.04.2008: Malacañang is No. 1 in Exec Hires – CSC.

06.-09.02.2011: PCIJ Series on the Office of the Ombudsman.

09.12.2012: Money Talk.

Philippine Daily Inquirer (PDI)

09.11.2000: Whatever Happened to ...? Withholding Tax Scam.

02.09.2002: RP Losses Due to Tax Leaks: P 380B/Yr.

12.07.2006: DOF Sacks Corruption Probers.

25.10.2006: Graft Prober Probed for Graft.

13.08.2007: Arroyo Asks BIR to Focus on 'Big Fishes'.

12.02.2009: Senate to Subpoena WB Exec.

24.03.2009: BIR Hopes Pacquiao Spurs Tax Payments.

14.09.2009: Opinion: Reveille, the GSIS and Winston Garcia.

06.07.2010: PBA Chairman to be Named Customs-Chief – Finance Chief.

26.11.2010: No Conflict of Interest in Apeco – Sen. Angara.

21.09.2011: Urban Planner Sues Angaras over Aurora Project.

15.10.2011: Ombudsman Conchita Carpio Morales Vows to Land Big Fish, Zero Backlog.

21.02.2012: Church Backs Repeal of Apeco Law; Cites Abuses in Free Port Project.

18.03.2012: I was Cleared, Says Ex-BIR Man.

28.03.2012: Pacman vs. Taxman: Pacquiao Faces 'Knockout' Charges.

03.05.2012: Pacquiao's Net Worth at P1.352 B, Imelda's at P932 M – House Papers.

15.05.2012: Cebu Gov Says Binay Won't Mind If She's Gloria Arroyo's Ally.

19.07.2012: 51 Party-list Representatives are Millionaires.

Philippine Star (PS)

17.04.2000: BIR Provides a 'Rich Broth' for Corruption.

18.04.2000: The Tax Men Share their 'Loot'.

19.04.2000: BIR Resisting Reforms.

05.05.2001: BIR Cashier Gets 2 Life Terms for Plunder.

17.08.2002: Bomb Threat at BIR, Pagcor Offices.

20.08.2002: BIR Chief Quits, Cries Foul.

20.08.2002: By-the-Way-Column: He Resigned? The Way René Bañez Was Shouted Out Means "No Reform".

30.08.2002: 'IRMA' to Replace 'BIR' Accepted by Workers' Union.

26.11.2003: GMA Denies Camacho Resigned because of GSIS Chief.

12.03.2004: BIR Official Who Failed Lifestyle Check Suspended.

23.01.2005: Putting Fiscal House in Order: GMA Revamps Economic Team.

01.02.2005: BIR Exec Fired for Dishonesty.

09.09.2005: DOF Agent Nabbed for Extortion.

03.12.2005: DOF Exec Quits, Cites Health Reasons.

18.03.2008: DOF Official Quits as Teves Fails to Hurdle CA.

02.07.2008: Rewards Legal – BOC.

26.09.2008: BOC Seeks Non-Cash Rewards for 2006 Performance.

22.07.2010: Merged Philip Morris, Fortune Tobacco Firm Gets 90% RP Market Share.

24.11.2010: Aquino Abolishes PAGC.

11.12.2010: Anti-Graft Executive Linked to Smuggling.

17.12.2010: DOF: Smuggling Suspect no Longer One of Us.

26.03.2011: BIR Offers P.5 M for Arrest of Officer's Killer.

- 29.03.2011: AFP Seen as 'Most Corrupt' Government Agency – Pulse Asia.  
10.05.2011: Purisima on Graft Raps: It's Harassment.  
21.03.2012: First Case: Tax Evader Faces Arrest, Imprisonment.  
03.07.2012: Marketer Convicted of Tax Evasion Missing?

### **9.1.7 International Newspapers and Magazines**

#### ABC News (ABCN)

- 14.03.2011: Indonesia President Slams 'Character Assassination'.

#### Asia News Monitor (ANM)

- 28.07.2011: Philippines: Malacañang Urges Filipino Citizenry to Pay Correct Taxes.

#### Asia Times (AT)

- 19.11.2003: Indonesia Goes After Expat Tax Scofflaws.

#### Banker (B)

- 05.01.2009: Finance Minister of the Year/ Asia: Margarito Teves, Finance Secretary, The Philippines.

#### Far Eastern Economic Review (FEER)

- 08.07.1965: Anti-Tax Move.  
07.10.1972: Mr Marcos Shapes the New Society, 12-15.  
07.10.1972: Week of Change, 15.  
03.10.1975: Overhauling the New Society, 13-15.  
08.06.1979: The Year of the Puppets.  
09.07.1992: Corporate Cabinet.  
05.07.2001: Graft and Taxes, 24.  
19.09.2002: Manila Comes to the Rescue, 12-16.

#### The Financial Times (FT)

- 20.08.2002: Manila Tax Chief Quits as Reforms Spark Anger.  
21.06.2007: Manila Fires Tax Chief to Rescue Budget.  
26.05.2010: Indonesian Ex-Minister Warns of Opposition to Reform.

#### Forbes (F)

- 13.12.2007: Forbes Indonesia: Indonesia's 40 Richest.  
17.06.2009: The World's 100 Highest-Paid Athletes in Pictures. No. 6 Manny Pacquiao.  
07.07.2010: The Philippines' Wealthiest.  
02.12.2010: Forbes Indonesia: Indonesia's Wealthiest.  
23.11.2011: Forbes Indonesia: Indonesia's 40 Richest.

#### Inside Indonesia (II)

- 16.12.2007: Muljono, Paramita: Glass Ceiling in Government. Women in the Ministry of Finance Face Significant Obstacles to Advancement.

#### New Straits Times (NST)

- 17.10.2003: Top Fraud Investigator Shot Dead.

#### New York Times (NYT)

- 26.10.2003: The Philippines Struggles to Cope with Deficits and Insurgents.

The Straits Times (ST)

09.09.2011: A National Identity Card Nightmare.

Unites States Today (UST)

16.11.2011: 57 Members of Congress among Wealthy 1%.

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