Handbook of Research on Public Finance in Europe and the MENA Region

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Chapter 1
Public Finance in Developing Countries: An Introduction

Vito Tanzi, Honorary President of the International Institute of Public Finance

This chapter presents a historical and theoretical overview of the public finance in general and for developing countries in particular. The chapter highlights that modern governments need revenue and often a lot more revenue than they needed in the past, to provide the levels of assistance and public services that modern societies expect governments to provide. However, because of the various potential problems before raising the countries’ tax levels with tax reforms, it is important that there must be a clear understanding of how that fiscal space will be used and how the additional tax burden will be distributed. It is emphasized that the necessary public institutions capable of enforcing the adopted policies competently and efficiently must exist. Otherwise, poor choices are likely to be made and the public investments undertaken tend to be not as productive as they had been expected.

Chapter 2
Transparency, Technology and Taxation

Richard Bird, University of Toronto, Canada

Taxes and tax administration are important. Taxation is one of the main interfaces between state and society: how a tax system is administered may affect not only its yield, its incidence, and its efficiency but also the state itself. Taxation that is widely perceived to be unfair and administered capriciously and corruptly may not only bring the tax system into disrepute but weaken trust in government and even the legitimacy of the state. This paper discusses two important aspects of taxation – its 'transparency' and the increasingly important role of information technology (IT) in tax administration, as well as how these two topics relate to the broader issues just mentioned.

Chapter 3
The Difficulties of Achieving Successful Tax Reform

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This chapter sets out the issues that should be considered in developing successful tax reform. Economic theory makes an essential contribution to the development of tax reform, incorporating issues of both economic efficiency and equity. However, other theoretical considerations demonstrate that successful tax design may be considerably more difficult than seems to be widely thought. In addition, there are matters of tax administration and compliance that have to be taken into account. The changing socio-economic environment within which tax systems have to operate as well, as the political process of tax reform, are also important. Finally, the chapter shows how to develop a systematic approach which can incorporate the many important issues that should be included in developing successful tax reform.
Chapter 4
Tax Revenues and Tax Efforts across the World

Nihal Bayraktar, Pennsylvania State University, USA
Blanca Moreno-Dodson, The World Bank, USA
Tuan Le, The World Bank, USA

This chapter focuses on the concept and empirical estimation of tax effort around the world. It employs a cross-country study from a sample of 121, developing and developed countries during 1994-2012. Predicted tax revenue of a country is estimated empirically taking into account its specific economic, demographic, and institutional features and is considered as an approximation of its taxable capacity. Tax effort is then defined as the ratio between the share of the actual tax collection and the predicted tax revenue. The use of tax effort and actual tax revenue collection allows us to rank countries into four different groups. The results vary per country and region but, overall, tax revenue collection appears to be in line with its predicted value. This could reflect many efforts undertaken in the last decades to improve tax policy and tax administration. It also suggests that further improvements in domestic revenue mobilization may require other non-tax reforms aimed at removing economic, demographic and institutional constraints hindering tax revenue performance.

Chapter 5
Public Investment and Fiscal Sustainability in the West African Economic and Monetary Union (WAEMU): Lessons for European and Middle Eastern and North African Countries

Mehmet Serkan Tosun, University of Nevada, USA
Serdar Yılmaz, World Bank, USA

This paper analyzes fiscal adjustments following economic shocks in the West African Monetary Union (WAEMU) countries. Using an unbalanced panel data, we examine empirically 81 developing countries including eight WAEMU countries over the 1980-2012 period. The paper compares the cyclicality of fiscal policy in WAEMU to other developing countries. While it focuses on the response of public investment to changes in GDP, we also examine responses of current public expenditure and fiscal balance. The paper finds that there is strong procyclicality in fiscal policy in WAEMU countries. Procyclicality is strongest in public investment and WAEMU countries are more procyclical in their fiscal policy compared to a group of countries that include European and Middle East and North African (MENA) countries.

Chapter 6
Political Competition Impacts on Government Expenditure Growth: An Evidence from OECD Countries

Ali Rıza Özdemir, Gazi University, Turkey

Political competition is defined as the level of control held by individual political parties as captured by the measures of effective number of parties, number of parliamentary parties etc. This paper investigates the effect of political competition on the rate of government expenditure growth using competing theories and panel data from 21 OECD countries. In the existence of political competition, neo-classical theories predict a relatively lower rate of growth, while public choice theories suggest an excessive rate. The empirical results presented here is more supportive of neoclassical predictions. The results also show that competition does constrain government growth even after controlling for ideology. Furthermore, the
results show that competition has a greater constraining impact on government growth when there is a change in the ruling party or coalition.

Chapter 7
Public Spending and Governance Performance: Evidence from Europe and the MENA Region
   Lodovico Santoro, University of Naples, Parthenope, Italy
   Salvatore Capasso, University of Naples, Parthenope, Italy

The main objective of the chapter is to study the interaction between the level and composition of government expenditure and governance performance in Europe and in MENA countries. The perceived level of corruption provides a possible measure of governance performance. The idea is that more corruption entails greater than optimally volumes of public expenditure and an inefficient allocation of this. The study involves a descriptive and a simple econometric analysis. Results are enlightening and point out that total government expenditure appears to be positively correlated to poorer governance performance, and hence to more corruption, only when the volumes of public expenditure is already high.

Chapter 8
Tax Systems, Economic Development and Good Governance: A Comparative Analysis of the MENA Countries
   Savaş Çevik, Selçuk University, Turkey

The chapter examines tax structure and its relation to good governance and economic development in the MENA countries. First, it discuss how different tax systems and tax structures in the region compared with other countries. MENA region can be characterized with low level of tax-to-GDP ratio compared to other groups of countries. However, tax systems considerably diverge within the region. Most importantly, whether having hydrocarbon revenues meaningfully divides the region’s countries with respect to tax composition, tax levels, tax ratios and tax regimes. Literature suggests that natural resource revenue is also an important determinant of governance and institutional development that have impact on economic development, while good governance, a more legitimate and responsive state is an essential factor for a more adequate level of tax effort. Therefore, the second section of the study examines the relationships between taxation and good governance with emphasis on the MENA region.

Chapter 9
International Tax Competition and Its Reflections in Turkey
   Semih Öz, Ankara University, Turkey

International tax competition has been significantly increased since 1980s as a result of liberalized financial and fiscal policies, while this leads sovereign nations faced budgetary deficit problems and public finance related considerations. This paper aims to analyze how Turkish tax system is affected by international tax competition, services submitted by tax havens and facilities used by multinationals. In 2006, a new Corporate Income Tax Law was introduced in Turkey. One of its purposes is to combat against harmful tax competition and therefore it covered defensive measures such as controlled foreign company (CFC), thin capitalization rule and transfer pricing regulation, to prevent companies from leaving their income abroad. This study aims to analyze effects of international tax competition in Turkey
whether there are change in tax rates, tax structure, and tax revenue; and how the government respond it, as a beneficiary; or, a loser.

Chapter 10
A Panel VAR Analysis of the Shadow Economy in Europe and MENA
   Tarkan Çavusoğlu, Hacettepe University, Turkey
   Debi Konukcu Onal, Hacettepe University, Turkey

The objective of this chapter is to analyze empirically the potential dynamics of the relationship among the size of the shadow economy, fiscal burden and the official economy. The empirical analysis is based on the size estimates of the shadow economy in 17 developed and 11 transition economies of Europe for the period 1999-2013 and in 16 economies of Middle East and North Africa for the period 1999-2007. Direction of causal relations among shadow and official economies and the fiscal burden is investigated by exploiting the panel vector auto-regression approach and the associated impulse response analysis, which directly account for the potential endogeneity of the variables of interest. Findings mostly confirm the view that shadow and official economies are substitutes, and the dynamic effects of fiscal burden on the shadow economy are not as strong and clear as expected in the regions in question.

Chapter 11
Shadow Economy and Tax Evasion: An Analysis for EU-27 and Turkey
   Hale Akbulut, Hacettepe University, Turkey

The aim of this chapter is to investigate shadow economy on an EU-27 and Turkey basis. For this purpose, firstly the definition, causes\ and consequences of shadow economy together with its relationship with tax evasion are discussed. In addition, the causes of shadow economy are examined for EU-27 during the period 2003-2012. It was done both statistically and empirically by employing scatter plot diagrams and the random effects model. While empirical findings confirm the effects of taxes, income level, trade and population on the shadow economy, statistical findings mention the effects of governance related indicators. Another main finding of this chapter is about Turkey. Accordingly, shadow economy in Turkey is observed to be higher than in the EU-27 and taking into consideration the comparative statistical findings about the causes of shadow economy, the main reasons of shadow economy in Turkey are thought to be governance related.

Chapter 12
Tax Compliance Behavior - An Upshot of Trust in and Power of Authorities across Europe and MENA
   Larissa Batrancea, Babes-Bolyai University, Romania
   Anca Nichita, Romanian Academy, Romania
   Ioan Batrancea, Babes-Bolyai University, Romania
   Erich Kirchler, Education and Evaluation University of Vienna, Austria

The volatility of the global economic market and the fierce competition in attracting foreign investments have determined European and MENA authorities to reconsider interactions with taxpayers. Thus, benefitting from international assistance, authorities have started implementing tax strategies and models like co-operative compliance, horizontal monitoring, whistleblowing. This empirical investigation is grounded on the “slippery slope” framework that attempts to solve the “riddle of tax compliance” via trust in and power of authorities. The former is proxied by “Trust in national government” (Gallup World
Poll), the latter by “Rule of law” (World Bank). The two-step cluster analysis run on 215 countries worldwide, including 35 from Europe, 12 from MENA, yielded four tax climates: trust and power high (T+P+), trust and power low (T-P-), trust high-power low (T+P-), trust low-power high (T-P+). While the majority of European countries are spread between T+P+ and T-P+, MENA countries generally belong to T-P-, demanding stability and efficiency in all major areas of the societies.

Chapter 13
Political Economy of Tax Evasion and Tax Loss in the Real Estate Sector: A Property Tax Reform Proposal for Turkey

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This chapter engages with political economy of tax evasion and tax compliance issues, particularly focusing on deficiencies and problems within property taxation system in Turkey. The chapter questions if there are any political preferences, legal arrangements or cultural issues facilitating tax evasion and tax loss in Turkey. It first identifies the degenerating effects of frequent application of tax amnesties, having a lax tax reconciliation institution, and less than logical way tax information confidentiality principle is applied in Turkey. Then, the chapter investigates peculiarities and specific difficulties of real estate sector in general in relation to taxation. Finally, a comprehensive property tax reform based on a semi-public valuation system is proposed to reduce tax loss in this sector.

Chapter 14
Attitudes toward Tax Evasion in Turkey: An Empirical Study using the Latest World Values Survey Data

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This chapter summarizes and analyzes the latest World Values Survey data on attitudes toward tax evasion in Turkey. In addition to examining the overall viewpoints of the 1601-person sample, we examine ethical attitudes from the perspective of the following demographic variables: gender, age, marital status, education level, employment status, occupation, social class, income level, happiness, position on the political spectrum, sector of employment, and confidence in government. Comparisons with other studies will be made to determine the similarities and differences between Turkish attitudes and the attitudes of people in other countries.

Chapter 15
The Future of Public Finances in Egypt

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Vjollca Sadiraj, George State University, USA
Sally Wallace, George State University, USA

Egypt, a country of 82 million people with a GDP of $272 billion, is arguably one of the most important countries in the Middle East. At this stage of its transition, the structure and level of public finances are more critical than ever. Like many countries, Egypt suffers from substantial non-compliance, which
undermines the entire system of public finance, yet there has been relatively little focus on addressing this issue in Egypt. This chapter is focused on a review of the recent history of Egypt’s public finances and a unique experiment that aims to better understand the potential for political institutions to affect tax compliance at a time when those institutions are under development.

Chapter 16
Analyzing and Reforming Tunisia’s Tax System

James Alm, Tulane University, USA

Tunisia’s tax system has undergone significant structural reforms over the last several decades. Even so, its structure exhibits some major flaws, shortcomings that spill over to and affect the performance of the overall Tunisian economy. Further, the tax system continues to underperform in some fundamental ways, ways that also affect the rest of the economy. Finally, the structure of the Tunisian tax system has some notable shortcomings. This paper discusses these issues. It presents details of the main taxes, it analyzes several main features of this tax system, and it suggests various specific tax reforms that can be introduced both in the short term and in the longer term.

Chapter 17
The Incidence of Taxes in Jordan

Sally Wallace, George State University, USA
Andrey Timofeev, Georgia State University, USA

The focus of this chapter is on the incidence of taxes in Jordan. All taxes must ultimately be paid by someone, and one of the most fundamental questions asked by economists is: “Who bears the final burden of a tax?” Taxes cause individuals and firms to change their behaviors, and the resulting changes in product and factor prices will affect the incidence and the distributional effects, of the tax. The answer to the question “Who bears the burden of the tax” requires us to estimate whether or not taxes are regressive; that is, do taxes as a share of income decrease or increase as income increases? This type of analysis is important for a country like Jordan, which is seeking to increase public revenue and encourage economic development. The analysis is also useful as a model for other countries in this important region.

Chapter 18
The Distributional Effects of Tax Expenditures in Turkey

Ömer Faruk Battrel, Istanbul Commerce University, Turkey

This chapter first discusses the Turkish tax policy performance for the period of 2004-2013 in terms of equitable distribution of tax burdens. Then, it examines tax expenditures, which are believed to be one of the main sources of inequity in tax burden distribution, in terms of equity and fiscal transparency grounds. The chapter also estimates tax expenditure figures based on very limited data in Turkey. One of the main findings of the chapter is that because fiscal transparency and non-discrimination principles of taxation are violated in Turkey, there are considerable amount of hidden tax reliefs that are not counted as tax expenditures in the Turkish tax system.
Chapter 19
Restructuring the Electricity Sector in Turkey: Who are the beneficiaries?
Mustafa Kahveci, İstanbul University, Turkey
Hülya Kirmanoğlu, İstanbul University, Turkey

Public utilities have been at the very center of economic and social development of countries. Until the last decades, they were almost exclusively undertaken by public authorities. From the 1980s, they have been subject to liberalization in many countries. Liberalization of electricity means that the segments which are vertically integrated are unbundled and opened to private sector through privatizations. However, since the transmission and distribution segments are networks that exhibit severe natural monopoly characteristics, they should be either owned and operated by public bodies or regulated by independent regulatory authorities to protect consumer interest. In Turkey, the liberalization process for the public utilities has begun in 1990s, but posed many problems at administrative and juridical stages. Lately, the legislative framework which is designed to be compatible with global standards has been completed. But at economic stage, we can easily observe the power of big companies and holdings outweigh the power of public authorities and counteract the public interest.

Chapter 20
Monetary and Fiscal Policy Interactions: An Empirical Evidence from Turkey
Asuman Oktayer, Yıldız University, Turkey
Nagihan Oktayer, İstanbul University, Turkey

While the role of fiscal policy in price level determination was neglected by the conventional theory, a new point of view was adapted by the Fiscal Theory of the Price Level. In the context of the new theory, monetary and fiscal policy interactions were taken into account and the role of fiscal policy was underlined. This paper investigates the monetary and fiscal policy coordination in Turkey during the period January, 1989 to February, 2012 and sub-periods January, 1989 to January, 2001 and February, 2001 to February, 2012. In order to reveal if financial policies are monetary dominant or fiscal dominant in aforementioned periods, bounds testing procedure is applied by using quarterly data. While the empirical test results related to the entire period of January, 1989 to February, 2012 and sub-period of January, 1989 to January, 2001 indicate fiscal policy dominant regime, the findings regarding February, 2001 to February 2012 imply monetary policy dominant regime in Turkey.

Chapter 21
Impacts of Global Financial Crisis and Changes in Monetary Policy of Central Banks: An Analysis of Central Bank of the Republic of Turkey (CBRT) and Israel (BOI)
İsmail Şiriner, Kocaeli University, Turkey
Keremet Shaiymbetova, Kocaeli University, Turkey

The Great Financial Crisis (GFC) has hit developed and developing countries through a number of transmission channel. Some impacts are already disappearing while others are still to strike. In MENA region developing countries to experience the crisis were those with the most globally integrated financial sectors. Next came the impact on trade, as volumes and prices of commodities and manufactures collapsed across the globe. Successful economic policies pursued in the past do not promise these countries’ immunity from the crisis. In fact, some MENA countries have already shown a limited
capacity to learn from other countries’ previous financial crises. Post-crisis spillovers and heightened capital flows have triggered a search for alternative monetary policy frameworks, especially for Turkey and Israel in MENA economies. This paper analyzes the review of the region’s monetary regimes and policies, including: monetary policy expansion of the monetary policy framework in promoting financial stability alongside the primary price stability objective.

Chapter 22
Fiscal Decentralization and Local Borrowing in Turkish Provinces

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There have been important developments in the decentralization of the government structure in Turkey since the early 1980s. This paper examines the link between fiscal decentralization and local borrowing within Turkish provinces. It first discusses local government reforms throughout the history of the Turkish Republic with the focus on recent reform efforts and current local government structure. It then provides an empirical analysis of the effects of decentralization in Turkish provinces using cross-sectional and panel data approaches, and spatial econometrics. The dataset consists of 67 provinces from 1980 to 2000, and separately cross-sectional data on all 81 provinces for the year 2000. Using decentralization measures such as number of local governments per capita and ratio of own-source municipal revenue to total provincial tax revenue, and specific characteristics of the municipalities the analysis examines whether variations in local decentralization across these provinces and across time have had a significant impact municipal borrowing in those provinces.

Chapter 23
Taxes, Natural Resource Endowment, and the Supply of Labor: New Evidence

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This chapter uses the work-leisure choice model to compute equilibrium weekly hours worked for a number of Arab countries and compare them to the G7 countries. It shows that the labor supply curve is elastic in all Arab countries, and provide a new measure of labor productivity. This finding confirms previous research that workers respond to incentives, which has serious implications for tax and social security policies. The chapter also provides some policy simulations pertinent to the effects of taxation on welfare and poverty.