



Tropentag, October 5-7, 2011, Bonn

“Development on the margin”

Emission Taxation under the Presence of Bribery: Experimental Evidence Inspired by the Indonesian Case

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Abstract

Deterioration of environmental quality is an important issue in Indonesia. The implementation of emission tax has been mainstreamed since 2008. However, the success of an emission tax is potentially hampered by several problems. The first problem concerns the conflicting objectives between government and industry. While the government seeks to reduce emission augmenting fiscal income, industry has an interest to elude taxes and raise profits. Within this field of opposing interests the issue of asymmetric information poses a challenge which is difficult to overcome. Monitoring helps to reduce information asymmetry but is costly to government, enabling the industry to take noncompliance action. Furthermore, the presence of bribery practice in the taxation directorate may hamper tax compliance further. The objective of this study is to provide clues about the impact of alternative principal agent design options on tax compliance under the presence of corruption. Design alternatives in our experiment include different combinations of tax rate, sanction rate, financial reward rate, and probability of audit. Our experimental set up also takes into account the presence of bribery in the taxation office and incorporates a bribe rate as a determinant of compliance. The experiment was conducted in Indonesia, with university students as participants. The experiments showed that under the absence of bribery, the compliance was mainly determined by audit intensity and sanction severity. The introduction of a financial reward for truthful emission reports increased compliance behaviour of participants. However, in a treatment with bribery, the use of a financial reward had no longer a significant effect on compliance. Under bribery, the price of the bribe significantly affected the behaviour of participants and tax increases were responded to by lowering the compliance. The results indicate that the easiest way to influence compliance is by setting a moderate tax rate, since tax compliance deteriorates with increasing tax levels. Furthermore, compliance can be increased by bringing down bribery which can indirectly be induced if the cost of bribery increases, for instance, by setting a severe punishment for bribe-receiving officers. Finally, only if bribery can be curbed, controlled financial rewards can be applied as a compliance incentive.

Keywords: Corruption, emission tax, environment, experiment, tax compliance