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CONTENTS

- 140 Editorial
Chris Evans
- 144 Corruption, complexity and tax evasion
Vito Tanzi
- 161 Corruption, taxation, and tax evasion
James Alm and Yongzheng Liu
- 190 Corruption, taxes and compliance
**Anja Baum, Sanjeev Gupta, Elijah Kimani and
Sampawende Jules Tapsoba**
- 217 The impact of corruption on tax revenues, tax compliance and
economic development: Prevailing trends and mitigation actions
in Africa
Bernd Schlenther
- 243 Causes and consequences of corruption in tax administration: An
Indonesian case study
Christine Tjen and Chris Evans
- 262 Tax and corruption: Is sunlight the best disinfectant? A New
Zealand case study
Lisa Marriott
- 290 Tax corruption and private sector development in Vietnam
Ngoc Anh Nguyen, Quang Hung Doan and Binh Tran-Nam
- 312 Applying foreign anti-corruption law in the Chinese tax context:
Conceptual difficulties and challenges
Nolan Sharkey and James Fraser

CONTENTS CONTINUED

- 333** Morality associated with fraud, corruption and tax evasion in South Africa
Boela (AP) Swanepoel and Jacolize Meiring
- 359** Addressing aggressive tax planning through mandatory corporate tax disclosures: An exploratory case study
Heidi Zummo, Bronwyn McCredie and Kerrie Sadiq

Tax corruption and private sector development in Vietnam*

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Abstract

This article aims to examine the impact of tax corruption on private sector development in Vietnam. It is motivated by two separate but related considerations. First, despite the seriousness of the phenomenon of corruption, there is a paucity of rigorous empirical research of corruption, particularly tax corruption, in Vietnam. Secondly, ineffective control of corruption is viewed as a cause of Vietnam's recent total factor productivity (TFP) slowdown or its poor industrial policy, both of which may hamper Vietnam's progress as a low middle-income country. Without some understanding on the impact of tax corruption on the economy, it may not be possible to devise the most effective anti-corruption policy and measures. After a brief literature review that focuses on tax corruption, various conceptual issues relating to tax corruption are discussed and clarified. The extent of petty tax corruption in Vietnam is then discussed, followed by a review of findings and implications of recent studies on how tax corruption impacts on private sector development in Vietnam. Despite perceptions and evidence of widespread petty tax corruption, Vietnam ranks very highly both in terms of tax collection and tax effort. Not unexpectedly, the impact of tax corruption is mixed in the sense that empirical evidence lends credence to both 'sanding the wheels' and 'greasing the wheels' hypotheses. Finally, some broad policy recommendations for combating tax corruption are offered.

Keywords: tax corruption, unofficial/informal payments, private sector, Vietnam

JEL Classification: H20, H26, H29

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1. INTRODUCTION AND CONTEXT

Vietnam's transition from an inward-looking, centrally-planned economy to an outward-looking, market-based economy formally commenced in 1986 although substantial, irreversible changes only took place in 1989 (World Bank, 1993, pp. i-ii). After three decades of economic reform, Vietnam has achieved certain commendable outcomes, especially in terms of economic growth, poverty reduction and macroeconomic stability. From being one of the 30 poorest countries in the world in the early 1990s,⁴ Vietnam has recently become a middle-income country (World Bank, 2013a) thanks to its steady growth rate since economic reform.⁵ Overall, it is an emerging transition country with a sizeable population⁶ and a dynamic economy with expanding international and investment trade ties.⁷

Despite these achievements, Vietnam has been facing a number of social, economic and political challenges such as productivity slowdown, widening income and wealth inequality, diminished environmental sustainability and, perhaps most seriously, corruption. While the phenomenon of corruption is widespread across countries and over time, it has been perceived by many different stakeholders as one of the most critical issues facing Vietnam at present (World Bank and Government Inspectorate of Vietnam, 2012). More specifically, the Communist Party of Vietnam has long identified corruption as a threat to its political legitimacy (Communist Party of Vietnam, 2006). Yet, despite a strong anti-corruption legal framework since 2005, very limited results have been achieved (Transparency International, 2017a).

In the above context, the principal aim of this article is to examine the impact of tax corruption on private sector development in Vietnam. The article is motivated by two separate but related considerations. First, despite the seriousness of the phenomenon of corruption, there is a paucity of rigorous empirical research of corruption in Vietnam. Further, there are hardly any studies that specifically focus on tax corruption although some studies nevertheless touch on some aspects of tax corruption. Secondly, there is an increasing concern in Vietnam that the country may fall into the 'middle income trap'. In this sense, many researchers have blamed ineffective control of corruption as a cause of Vietnam's recent total factor productivity (TFP) slowdown (see, for example, Vu, 2016) or its poor industrial policy (Ohno, 2016, p. 35). Without some understanding of the impact of tax corruption on the economy, it may not be possible to devise the most effective anti-corruption policy and measures.

The scope of this article is limited to tax corruption that involves at least one tax official. Illegal business practices involving firms only (e.g., one business issuing fake value added tax (VAT) invoices to another business) do not constitute tax corruption

⁴ In terms of GDP per capita in purchasing power parity (PPP) dollar terms, Vietnam was ranked among the 30 poorest countries in the world in 1990 when estimates of its GDP per capita in PPP dollars first became available; see various issues of the United Nations Development Programme (UNDP) *Human Development Report*.

⁵ Vietnam's GDP grew at an average annual rate of 7.2 per cent in the first decade of the 21st century (World Bank, 2012).

⁶ Vietnam's population in 2015 was estimated at about 93.4 million, making it the 14th most populous country in the world (United Nations, 2015, p. 17, Table 5.1).

⁷ Vietnam's trade-to-GDP ratio decreased from 157.4 per cent in 2008 to 130.7 per cent in 2009 but then rebounded to 147.6 per cent and 164.8 per cent in 2010 and 2011, respectively (World Bank, 2013b).

for the purposes of this article. Furthermore, due to data limitations, the empirical examination is confined to petty tax corruption, i.e., relatively small ‘unofficial/informal’ payments (bribes) made to tax officials during the process of assessing and collecting tax revenue in Vietnam. The article focuses on the impact of petty tax corruption on the private sector, which is widely considered to be the engine of growth and development in Vietnam in the long run.⁸ Finally, the development of the private sector is studied in terms of four dimensions: innovation, investment, employment and per capita income.

The remainder of this article is organised as follows. Section 2 presents a brief literature review on tax corruption, including some recognised Vietnamese studies (available in English). In section 3, various conceptual issues relating to tax corruption are discussed and clarified in order to prepare the ground for the discussion that follows. These include definition and types of tax corruption, its measurement, and its causes and consequences, mainly from a Vietnamese perspective. Section 4 reviews the extent of tax corruption in Vietnam while section 5 presents an overview of private sector development in Vietnam, and then discusses the implications of empirical findings on how tax corruption impacts on private sector development in Vietnam. Despite the perception and evidence of widespread petty tax corruption, Vietnam ranks very highly both in terms of tax collection and tax effort. Not unexpectedly, the impact of tax corruption on private sector development is mixed in the sense that empirical evidence lends credence to both the ‘sanding the wheels’ and ‘greasing the wheels’ hypotheses. The final section offers some summary remarks and proposes various recommendations for mitigating tax corruption in Vietnam.

2. BRIEF LITERATURE REVIEW ON TAX CORRUPTION

The economic literature on corruption is long-standing and very substantial (see, for example, Leff, 1964; Mauro, 1995; Tanzi and Davoodi, 2000; Kaufmann, Kraay & Mastruzzi, 2011). A significant proportion of this literature is devoted to economic growth and development. In this context, two opposing hypotheses, namely that corruption ‘sands the wheels’ and ‘greases the wheels’ of growth, have been theoretically established and empirically tested. The results obtained to date from these empirical tests have been mixed (see the reviews in this field by Méon and Weill, 2009, and Nguyen, Nguyen and Tran-Nam, 2016). Since the literature on corruption in general has been well discussed elsewhere (see, for example, Rosid, 2017) and in view of the focus of this article, it suffices to focus on the literature on tax corruption.

By definition, tax corruption is a strict subset of corruption. Furthermore, tax corruption is necessarily intertwined with tax evasion (and tax avoidance to a lesser extent) because taxpayers who bribe are often motivated by tax evasion/avoidance and tax officials who receive bribes will find it necessary to hide their receipt of illegally

⁸ The term ‘private sector’ is employed in this article to mean the non-state sector. In Vietnam, the non-state sector is divided into the private (i.e., domestic private) sector and the Foreign Direct Investment (FDI, i.e., international private) sector.

obtained income. Thus, tax corruption involves a very important intersection of corruption and tax evasion.

There are several strands of research on tax corruption that can be identified in the general literature on tax corruption. These areas are: (i) determinants of tax corruption; (ii) impact of corruption on tax compliance including firm tax evasion; and (iii) strategies to reduce tax corruption. Each of these strands will be briefly considered in turn.

2.1 Determinants of tax corruption

Richardson (2006a) examined the influence of culture (proxied by power distance,⁹ individualism, uncertainty avoidance and masculinity) on petty tax corruption (irregular payments or bribes). Based on sample data of 47 countries drawn from the World Economic Forum's *Global Competitiveness Reports* 2002-04 and other sources, and after controlling for economic development (bureaucratic compensation), size of government and democracy, it was found that the higher the level of power distance and uncertainty avoidance, the higher is the level of petty tax corruption in a country. While those findings are plausible, the potential endogeneity between tax corruption and uncertainty avoidance casts some doubts on the strict applicability of the OLS estimation employed by that author.

In a similar study, Richardson (2006b) studied the influences of the level of tax evasion, tax law complexity and level of self-assessment on petty tax corruption. Based on sample data of 48 countries drawn from a wide range of sources (mainly the *Global Competitiveness Reports* 2002-04), and after controlling for the three economic and political variables mentioned above plus the top marginal individual income tax rate, it was found that the lower the level of tax evasion and tax law complexity, and the higher the level of self-assessment, the lower is the level of petty corruption. Again, while the results are sensible, it is unclear to what extent the potential endogeneity between petty tax corruption and tax evasion undermines the OLS estimation results obtained.

2.2 Impact of corruption on tax compliance

There is a series of studies examining the impact of corruption on tax compliance. This relationship has been found to be negative in practically all cases. For example, using an international cross-section of 30 developed and developing countries, Pincur and Riahi-Belkaoui (2006) showed that individual tax compliance internationally is negatively related to the control of corruption. Similarly, based on a sample of over 5,000 firms from 22 former Soviet Bloc transition economies (extracted from the World Bank and European Bank for Reconstruction and Development's 2005 Business Environment and Enterprise Performance Survey (BEEPS)), Alon and Hageman (2013) found that a higher level of corruption is associated with a lower level of firm tax compliance. Utilising micro-level data from the Afrobarometer Survey Wave 5 (covering 35 African countries, mostly from the sub-Saharan region, during the years 2011-13), Jahnke (2015) demonstrated that personal experiences of petty corruption not only directly lower tax morale (willingness to pay taxes) but also

⁹ Power distance refers to how paternalistic the relationship between superiors and subordinates is. The more paternalistic, the higher is the power distance.

indirectly affect tax morale via reduced trust in the tax collection agency. While these studies used corruption overall as a determinant, it seems plausible that the same results would hold when corruption is substituted by tax corruption.

More recent studies of corruption and firm tax evasion have explicitly recognised the interaction between corruption and tax evasion. Based on firm-level data obtained from the World Enterprise Survey and BEEPS covering 8,000 observations and 32 countries, Alm, Martinez-Vazquez and McClellan (2016) applied the instrumental variable method to control for the potential endogeneity of corruption and tax evasion. As a robustness check, the method of propensity score matching was also employed. Their results indicated that it is corruption that largely drives tax evasion, in that: (i) requests for bribes reduce reported taxable sales, and (ii) larger bribes result in higher levels of tax evasion. In a theoretical study of business culture and tax evasion, Çule and Fulton (2009) constructed a coordination game to show that multiple equilibria can exist. In an unfavourable equilibrium (high cheating and corruption), increases in auditing or penalties may have perverse impacts and increase tax evasion. An externality between firms and tax inspectors is the source of this perverse effect: more tax evasion by firms is good for bribe-taking inspectors and more bribe-taking inspectors are good for tax evading firms.

2.3 Strategies to combat tax corruption

In terms of combating tax corruption, the literature is not consistent in its findings and implications. For example, in an early contribution, Flatters and MacLeod (1995, p. 397) proposed that '[s]ome tolerance of corruption can be part of an efficient collection system, especially when there are constraints on government wages or effort is required to learn payers' tax liabilities'. In contrast, Fjeldstad and Tungodden (2003) put forward an opposite argument on three grounds. First, while an increase in corruption may raise tax revenue in the short run, the opposite result generally holds in the long run. Secondly, the value of reducing corruption exceeds that of reduced tax evasion and higher revenue. Thirdly, eliminating corruption should be viewed as an end, not a means, in itself.

Turning to Vietnam, the literature on corruption has only recently emerged due to the sensitivity of the issue and lack of systematic data until about a decade ago. As a result, there has been very little research on corruption, let alone tax corruption, in Vietnam. An interesting study that deserves mention is that by Rand and Tarp (2012) who investigated the determinants of bribes and changes in bribe-paying behaviour by Vietnamese firms. Applying a pooled probit model and a fixed-effect linear probability model to firm-level data obtained from the United Nations University's 2005 and 2007 Vietnam Small and Medium Enterprises Surveys (VSMES) covering 1,659 firms in 10 provinces, Rand and Tarp (2012) found that: (i) bribe incidence among SMEs in Vietnam is closely related to firm-level differences in sunk costs and ability to pay; (ii) the magnitude of bribes is higher for firms that get preferential tax benefits and government contracts, and (iii) there is evidence indicating a decline in firm-level corruption from 2005 to 2007.

During 2013-14 the UK Department for International Development (DFID) sponsored an anti-corruption research program in Vietnam (see Tromme, 2016). The program involved a series of empirical studies utilising a variety of research methods and data sources. These studies examined the impact of corruption on economic growth (Nguyen, Nguyen & Tran-Nam, 2016), provincial development (Dang, 2016), firm

innovation (Nguyen, Doan, Nguyen & Tran-Nam, 2016), firm strategy (Nguyen, Ho, Le & Nguyen, 2016) and household business sector (Dang et al., 2016). They were published in a special issue of *Crime, Law and Social Change* in 2016 and have remained the most comprehensive, up to date and authoritative set of studies on corruption in Vietnam. While most of these studies are concerned with general corruption, the findings can plausibly carry over to tax corruption. In the only study that focused on tax corruption, Dang et al. (2016) found that: (i) bribes result from both extortion and collusion, and (ii) bribe payments are often perceived as a normal cost of doing business.

3. CONCEPTUAL ISSUES

Before proceeding further, it is useful to clarify key concepts and theoretical relationships. To this end, we shall in turn discuss the meaning, measurement, causes and consequences of tax corruption.

3.1 Definition and types of tax corruption

Like needs and poverty, corruption is a social concept so that its meaning is not only relative but also context dependent. What is considered as corruption at a particular place and time in a particular context may not be regarded so at a different place and time or in a different context. The meaning of corruption is comprehensively reviewed in Rosid (2017, ch. 3). While corruption can be defined in various ways, there is nevertheless a near-universal agreement on two essential characteristics of corruption, namely: (i) illegal/illegitimate use/exercise (or misuse/abuse) of public office/power, and (ii) private/personal gains/benefits. Note that, especially in the context of developing/transition economies, these benefits consist of not only financial but also non-financial rewards. Not surprisingly, corruption often goes hand in hand with nepotism and cronyism in these countries.

For a variety of purposes, it is necessary to adopt a formal definition of tax corruption. To this end, tax corruption is defined as the ‘behaviour on the part of tax officials to improperly and unlawfully enrich themselves, or those close to them, by the misuse of the public power entrusted to them’ (Li, 1997, p. 475). This definition seems to be precise yet sufficiently broad to capture the various characteristics of tax corruption discussed above. More importantly, it explicitly mentions the benefits to people who are close to the corrupted tax officials. This is most relevant in countries such as China or Vietnam where the traditional culture encourages sharing, especially among members of the extended family or local community.¹⁰

In terms of the operation of the tax system, one may, in principle, distinguish between tax policy corruption, tax administration corruption and tax dispute resolution corruption. Tax policy corruption represents an example of the classification of ‘political’ corruption by Transparency International. This refers to ‘a manipulation of policies, institutions and rules of procedure in the allocation of resources and financing by political decision makers, who abuse their position to sustain their power,

¹⁰ There is a Vietnamese saying that ‘One mandarin helps the whole clan’ (*Một người làm quan cả họ được nhờ*).

status, and wealth' (Transparency International, 2017b). However, it is generally not possible to find evidence of tax policy corruption in practice. This is especially true for Vietnam in view of the consensual-based decision-making process at the national level (Lucius, 2009, p. 13). Vietnam is a civil law country in which the courts play a very insignificant role in resolving tax disputes so the scope for tax dispute resolution corruption is negligible. Thus, in practice, all empirical studies of tax corruption necessarily focus only on tax administration corruption. Thus in this article, from this point on, tax corruption refers to tax administration corruption, unless otherwise stated.

In terms of scale, tax corruption can be divided into petty and grand (United Nations Development Programme, 2008, p. 6). Petty tax corruption refers to the bribes (known in Vietnam as informal or unofficial payments) received by relatively low-level tax officials (tax inspectors/auditors) in their interaction with taxpayers (individuals and firms). Grand tax corruption, on the other hand, refers to the abuse of public power by high-level tax officials, such as directors or senior staff, for their personal gains. Grand tax corruption occurs much less frequently but involves much larger sums of money than petty tax corruption. In view of the lack of concrete data on grand tax corruption in Vietnam, tax corruption in this article from now on will refer to petty tax administration corruption, unless otherwise stated.

In terms of process, petty tax corruption can be further classified into extortion and collusion. In the case of collusion, the bribery is often suggested by the taxpayer and the amount is normally arrived at after a process of negotiation, whether explicitly or implicitly. In the case of extortion, it is the tax official who first makes the demand for the bribe. In both cases, the amount of the bribe tends to be proportional to the amount of taxation that is in dispute.

In the literature, the bribe-taking behaviour of tax officials is supposed to be conducted in an isolated and independent manner, and the bribes normally take the form of cash or gifts. In Vietnam, there is a range of anecdotal evidence that tax corruption appears (or at least is perceived) to be widespread, loosely organised and taking many forms. More specifically, tax-related bribes often go hand in hand with nepotism and favouritism (i.e., appointment of inappropriate candidates due to their family ties or close relationships with the Communist Party of Vietnam, etc.)

Because of the many forms of tax corruption in Vietnam, it can still take place in isolation. In terms of interaction between tax officials and taxpayers, tax corruption can be further divided into the following categories:

1. one tax official in isolation: embezzlement, inappropriate appointment/promotion of tax officials (due to bribery, family ties, political connection, etc) or revealing sensitive tax information to the wrong party;
2. one or more tax officials and one taxpayer: bribery (cash, gift, renting or buying assets below market prices, paying for private expenses such as meals or tours) or recruitment/promotion of persons related to the tax official(s) in the taxpayer's business;
3. two or more officials: excessive gifts to curry preferential treatments (e.g., appointment of relatives, own promotion) from superiors or an informal scheme of bribe-sharing between tax officials.

It is noted that while the above classification also applies to general corruption, the frequency and scale of bribery are most severe in the case tax corruption, at least in the context of Vietnam.

3.2 Measurement of tax corruption

For any given specific definition of tax corruption, exact measurement of tax corruption is impossible for a number of obvious reasons. First, due to its secret and illegal nature, direct and systematic observations of tax corruption are not possible. Secondly, as discussed previously, tax corruption has several different dimensions and it may not be possible to combine these aspects into a single measurement or index. Thus, it is very problematic to arrive at a set of measures of tax corruption which are comparable across countries and consistent over time.

Broadly speaking, there are two different approaches in measuring tax corruption, namely objective measurement and subjective measurement. An objective measurement of tax corruption may include, for example, the frequency and the amount of bribery that a taxpayer makes to tax officials. Such information can in principle be collected from taxpayers through the means of a questionnaire- or interview-based survey. In addition to the conventional data problems arising from survey research, it is unclear whether respondents truthfully reveal the full extent of their bribery behaviours. An objective measurement of tax corruption can be further categorised into an absolute measure (e.g., the average dollar value of the tax-related bribes) or a relative measure (e.g., the ratio of bribe payments to official tax liability or the ratio of bribe payments to firm's total costs or profits).

A subjective measurement of tax corruption seeks to obtain (normally informed) views/perceptions of relevant stakeholders such as tax officials, business entities, institutional agencies (including donors) and individuals through questionnaire-based surveys. This is by far the most widely-used approach in gauging the level of tax corruption in countries around the world, including Vietnam.

Objective and subjective measurements of tax corruption discussed above constitute direct measures of tax corruption. An additional means to assess the extent of tax corruption is to rely on a set of indirect measures, which can be either objective or subjective. For example, it is well known that tax corruption often occurs as a result of the interaction between tax officials (inspectors and auditors) and taxpayers. Thus, in the case of tax corruption, indirect measures may include the Paying Taxes indicators compiled by the World Bank. Similarly, aggregate measures such as tax collection (tax revenue/GDP) or tax effort (to be further discussed later, in section 4.3 below) can also be loosely used as indirect, macro measures of tax corruption.

3.3 Causes of tax corruption

There is a variety of general and specific causes of tax corruption in Vietnam. Since most of the general causes have been well-discussed in the literature, it suffices to mention them only briefly here.

3.3.1 General causes:

1. political: lack of transparency, accountability and genuine will to fight corruption;

2. institutional: lack of a competent public sector; no objective measure of public sector performance; job-buying practice in the public sector;
3. cultural: sharing within the extended family of local community; compromising and paternalistic culture;
4. economic: low wages in the public sector (no public servant can survive on his/her official salary!).

3.3.2 *Specific causes:*

1. tax law complexity: tax law can be interpreted in different ways (under the civil code approach, Vietnam's tax law cannot cover all cases that may arise in practical situations);
2. tax discretions: tax officials have many discretions (e.g., assessing turnover for the purposes of presumption taxes);
3. tax administration: no self-assessment, frequent site visits to business taxpayers, no effective system of independent tax dispute resolution;
4. business practice: poor tax and accounting record-keeping;
5. business motive: desire to pay as little tax as possible.

3.4 **Consequences of tax corruption**

Tax corruption gives rise to a number of harmful consequences on social welfare and economic development (see, for example, Purohit, 2007). First, and most apparently, tax corruption causes a loss in the tax revenue collected. This revenue leakage is particularly damaging to developing and transition economies which rely heavily on tax revenue for the provision of much needed public goods and services for economic development such as health and education.

Secondly, and also quite obviously, tax corruption causes distortion in the allocation of resources, including the allocation of talents. Together with other forms of corruption, it reduces the efficiency of both the private and public sectors, and decreases the inflows of foreign direct investment. At the firm level, the costs and benefits of corruption are not always unambiguous. While firms may enjoy some short-term benefits from tax corruption, it erodes their long-term business integrity and strategic capability. All of these lead to lower economic growth and development in the long run.

Thirdly, and less apparently, tax corruption reduces the policy equity of the tax system. This is because those who enjoy the benefits of tax corruption tend to be higher-income individuals. Their undeclared, illegal income from bribery reduces the distributive function of the income tax system, which in turn contributes to increasing income inequality in the society. This is particularly serious in transition economies such as Vietnam where there has been a steadily widening gap in the distribution of household income.

Fourthly, perception of tax corruption may have an adverse effect on the tax morale of taxpayers (see Rosid, 2017). This in turn weakens voluntary tax compliance which is fundamental to the success of any modern tax system.

Finally, perception of tax corruption itself reinforces the public's perception of general corruption which is a serious threat to the political legitimacy of the government, including in one-party countries such as Vietnam.

4. EXTENT OF TAX CORRUPTION IN VIETNAM

There is a range of primary evidence, both anecdotal and documented, that Vietnam has remained confronted with widespread tax corruption. In this section, we start by presenting evidence of general corruption in Vietnam. It is then followed by evidence of tax corruption. Finally, we discuss Vietnam's tax collection and tax effort. Somewhat surprisingly, despite evidence of prevalent tax corruption, Vietnam has been performing well in terms of both tax collection and tax effort.

4.1 Extent of general corruption in Vietnam

Vietnam performs consistently poorly in terms of international measures of general corruption such as the Corruption Perceptions Index (CPI). During the period 2011 to 2016, Vietnam's CPI level improved slightly from 29 to 33 (0 is highly corrupt and 100 is highly clean) but its ranking slightly worsened from 112 out of 184 to 113 out of 176 (Transparency International, 2017a, 2017c). The Global Corruption Barometer Report (involving about 22,000 people living in 16 countries from 2015 to 2017) confirms Vietnam's poor standing. Along with Malaysia, Vietnam was the worst performing country in the Asia Pacific region (Transparency International, 2017d, p. 27). In particular, the government was rated poorly in its efforts to fight corruption and bribery was very high.

While the World Bank's Worldwide Governance Indicators support the above findings, an improvement in Vietnam's control of corruption has been detected. The control of corruption indicator increased steadily from 25 in 2005 to 33 in 2010 and to 39 in 2015 (on a 0 to 100 scale, with higher values corresponding to better outcomes; World Bank, 2017a).

There is also some domestic evidence of the seriousness of general corruption derived from the 2012 survey sponsored by the World Bank and Government Inspectorate of Vietnam. Some interesting results are summarised below (World Bank and Government Inspectorate of Vietnam, 2012, pp. 30, 35 and 84 respectively):

1. after costs of living, corruption is perceived as the second most serious issue according to public officials, business and individuals;
2. at the national level, high-income individuals consider corruption to be more serious than average or low-income individuals;
3. to pressure businesses to make unofficial payments, public officials' three most common practices are intentionally prolonging time, giving no clear guidance/finding faults, and sticking to ambiguous regulations.

4.2 Extent of tax corruption in Vietnam

4.2.1 Indirect measure: Paying Taxes indicators

As previously argued, Paying Taxes indicators derived from the World Bank's *Doing Business* Report can serve as an indirect measure of tax corruption because there is potentially a positive association between tax compliance burden (including dealing with tax inspectors' site visits) and petty tax corruption. In the 2015 calendar year, paying taxes in Vietnam (540 hours) took more than 2.5 times longer than it did in the average of the East Asia and Pacific (198 hours) (World Bank, 2017b).¹¹ Similarly, the number of tax payments in Vietnam in 2015 (31 times) also far exceeded the average of the East Asia and Pacific Region (22.9 times).

4.2.2 Direct, subjective measure: perception of tax corruption in Vietnam

Relevant results from the 2012 survey sponsored by the World Bank and Government Inspectorate of Vietnam are summarised below:

1. in terms of perception of the prevalence of corruption, out of 22 sectors, customs and taxation rank 3rd and 9th respectively, according to public officials, businesses and individuals (World Bank and Government Inspectorate of Vietnam, 2012, p. 38);
2. out of 22 sectors, customs and taxation rank as the 4th and 6th most corrupt sectors respectively, according to public officials, businesses and individuals (2012, p. 39). This represents some improvement since customs and taxation ranked as the 2nd and 4th most corrupt sectors respectively in the 2005 Survey (2012, p. 82);
3. tax officials are identified by businesses as the public officials creating the most difficulties and the ones that have been given the most unofficial payments and gifts (2012, pp. 44-45);
4. in the taxation sector, unofficial payments are actively suggested by businesses (almost 90 per cent of all cases) and only in about 10 per cent of cases are the unofficial payments demanded (2012, p. 46);
5. the probability that individuals coming in contact with tax officials must pay a large bribe is only 0.5 per cent (not surprising in view of the small role played by the income tax in Vietnam) (2012, p. 52);
6. in the case of individuals making unofficial payments to tax officials, 83 per cent are voluntary (2012, p. 55).

4.2.3 Direct, objective measure of tax corruption in Vietnam

1. The Vietnam Chamber of Commerce and Industry (VCCI) conducted a national survey of more than 2,500 registered businesses in 2015. The survey indicates that 32 per cent of registered businesses in Vietnam had to make

¹¹ This refers to the number of hours that a medium-size company must spend to pay (or withhold) all taxes and mandatory contributions in a given year.

unofficial payments and 40 per cent believed that their businesses would be poorly treated without bribery (VCCI, 2015);

2. similar but more detailed data on tax corruption are also available from the Vietnam Provincial Competitiveness Index (PCI) and Surveys of Small and Medium Manufacturing Enterprises in Vietnam which have been conducted at regular time intervals. These data more or less confirm the picture painted above.

4.3 Vietnam's tax collection and tax effort

For completeness, we now consider Vietnam's tax collection and tax effort. Tax collection is conventionally defined as the ratio of actual tax revenue to GDP. Tax effort is defined as the ratio of tax collection to taxable capacity where taxable capacity refers to the predicted tax collection ratio that can be estimated by regression analysis, taking into account a country's specific, time-varying macroeconomic, demographic and institutional features (Le, Moreno-Dodson & Bayraktar, 2012, p. 3).

Using tax collection and tax effort allows us to rank countries into four separate groups: (i) low tax collection (below the median value of the sample), low tax effort (below 1); (ii) high tax collection, low tax effort; (iii) low tax collection, high tax effort, and (iv) high tax collection, high tax effort. *A priori*, a country with widespread tax corruption is expected to belong to the low tax effort group. Similarly, a country at a low level of economic development is expected to belong to the low tax collection group. Thus, Vietnam would be expected to belong to the low tax collection, low tax effort group.

Surprisingly, however, Vietnam in fact belongs to the high tax collection, high tax effort group (Le et al., 2012, p. 25). Its average tax collection during the period of analysis from 1994 to 2009 was above 18.31 per cent (median value of the tax collection in the sample). That Vietnam has a high tax collection, relative to its GDP per capita, is well known. In fact, Vietnam is known to have one of the highest tax collection ratios in the region.

What is much less known is Vietnam's tax effort. During 1994-2009, Vietnam's average tax effort index was 1.31, the highest in East Asia and the 16th highest in the world (Le et al., 2012, pp. 19-20). Vietnam's remarkable tax effort may lend credence to the argument put forward by Flatters and MacLeod (1995, p. 397) that, at least in the short run, an efficient collection system can be consistent with petty corruption, particularly when there are constraints on government wages or effort is required to learn businesses' tax liabilities.

5. IMPACT OF TAX CORRUPTION ON PRIVATE SECTOR DEVELOPMENT IN VIETNAM

In this section we first provide an overview of private sector development in Vietnam and how private businesses in Vietnam deal with their domestic tax obligations. We then review how and why business taxpayers in Vietnam bribe tax inspectors, and how tax corruption affects the development of the private sector in Vietnam using four dimensions of analysis, namely innovation, investment, employment and per capita income.

5.1 Private sector development in Vietnam

Following its reunification in 1975 Vietnam officially adopted a central planning economic regime throughout the country. Such a policy choice, coupled with other external difficulties, produced disrupting economic failure in Vietnam. This necessitated the introduction of *Doi Moi* (economic renovation) in 1986, which saw the emergence of the private sector in 1989: agriculture was decollectivised, private land use rights established, the majority of prices and the financial sector liberalised, many restrictions on private sector activity eliminated and trade and investment opened up (see, for example, Tran-Nam, 1999).

The most significant legal development for the private sector in Vietnam was the promulgation of the Enterprise Law which came into effect from 1 January 2000. This law replaced the old Private Enterprise Law and Company Law to establish a more favourable business environment for the private sector development. As a result, the number of new businesses has since increased very rapidly. For example, the average number of newly registered enterprises per day during the period 2000-05 was 3.75 times higher than that of the 1991-99 period. This rising trend has accelerated further in recent years. There were 14,453 newly established enterprises in 2000 and this number was estimated to be more than seven times larger in 2010 with 103,170 new businesses (Business Insides, 2011).

Because of its rapid growth and contribution to the economy, Vietnam's private sector is considered to hold the key to Vietnam's future economic success. Estimates of the contribution of the private sector (called the non-state sector) to GDP in Vietnam vary from source to source. According to the Organisation for Economic Co-operation and Development (OECD, 2014), private enterprises accounted for more than 50 per cent of GDP and created 60 per cent of all new jobs in 2013. Despite its growing importance, the private sector in Vietnam remains relatively underdeveloped and faces major constraints. Some of the main problems are briefly discussed below.

First, private enterprises do not compete on an equal footing with state-owned enterprises (SOEs), especially in terms of access to land and credit. Secondly, most of private enterprises are of small and medium size. For example, in 2005 more than 85 per cent of private enterprises had less than VND 1 billion (about USD 45,000) in total capital. According to the criteria specified in the new Decree 56/2001/ND-CP,¹² about 96 per cent of private enterprises are SMEs although the scale of their operation has been expanded in recent years. Thirdly, as a consequence of being small and having little protection from the government, private enterprises are more likely to become vulnerable to global economic changes. A study by Le (2009) suggested that the 2009 global economic slowdown affected 57.5 per cent of SMEs in Vietnam while only 40.4 per cent of large firms were affected.

¹² This decree defines the size of a business (micro, small, medium or large) according to total capital (the priority criterion except for the micro category) or average annual number of employees. The threshold definitions vary according to the industrial sector (primary, manufacturing and service). For all sectors, a business which employs 10 workers or less is said to be micro. For the primary/manufacturing sectors, a business is said to be small (medium) if it has a total capital of VND 20 billion or less (between more than VND 20 billion and VND 100 billion), or it employs between more than 10 to 200 (between more than 200 and 300) workers. For the service sector, a business is said to be small (medium) if it has a total capital of VND 10 billion or less (between more than VND 10 billion and VND 50 billion), or it employs between more than 10 to 50 (more than 50 and 100) workers.

In spite of the above constraints, the private sector is an engine of innovation and hence productivity and efficiency. In particular, estimates by global management consulting firm McKinsey found that with one additional unit of capital the private sector in Vietnam produces three times the additional revenue compared to SOEs (reported in Kim, 2014). In recent years, Vietnam's efficiency and productivity has stagnated and, as a result, its annual GDP growth has slowed to around 5 per cent. It is argued by many researchers that Vietnam's total factor productivity slowdown has been primarily caused by resource misallocation within its economy and there would be a very substantial productivity improvement if these distortions were removed (Doan et al., 2016, p. 105).

5.2 Paying taxes in Vietnam

There are about 10 different types of formal taxes in Vietnam (see PricewaterhouseCoopers, 2017). However, the main taxes that are relevant to businesses are value-added tax (VAT), corporate income tax, excise tax (known in Vietnam as special consumption tax), and import and export taxes. In terms of reporting frequency and burden, VAT and corporate income tax are by far the most significant business taxes in Vietnam.

Businesses in Vietnam are generally required to register with the tax administration (the General Department of Taxation (GDT) or its city and local offices) within 10 working days of their formal establishment. Each registered business will be supplied with a business tax registration certificate and a unique tax code. Businesses then have to report their estimated tax obligations by filing certain forms at a certain frequency depending on each tax type (VAT, corporate income tax, excise tax, import and export taxes).¹³ There is also a regulation on tax payment deadlines according to which enterprises have to pay their taxes arising from the period that corresponds to the frequency of tax payment. Otherwise, they must pay an additional penalty for being late in paying tax dues.

Large enterprises are required to report and pay their VAT liabilities on a monthly basis while SMEs do so on a quarterly basis. There are two ways of calculating VAT, namely, the conventional credit-invoice method and the direct method. Under the direct method, VAT tax liability is calculated by multiplying business turnover by a VAT rate which varies from industry to industry. The direct method is only available for newly established enterprises or enterprises with turnover below VND 1 billion (or USD 45,000).

In contrast to VAT, corporate income tax in Vietnam is reported and paid to the tax authorities on a quarterly basis. Prior to 2014, enterprises were required to file the tax declaration form quarterly in detail and pay that monetary amount. However, since the fourth quarter of 2014, enterprises only have had to estimate their corporate income tax liabilities and pay that amount without any additional declaration. Besides the requirement of estimating and paying corporate income tax in each quarter, the regulation on corporate income tax also requires that the total of estimated taxes should be no less than 20 per cent of total actual tax from the same period. Otherwise,

¹³ For household businesses, the tax authority will assign them a presumptive amount of tax liability and every household business is required to pay this assigned tax obligation.

the enterprises will have to pay the difference and an additional amount of penalty for the late payment of the difference.

As expected, the large business sector has played a key role in tax payment in Vietnam. However, an examination of tax revenue share by business size from 2000 to 2015 reveals three interesting trends.¹⁴ First, the contribution of the large business sector to total tax revenue has declined from about two-thirds (about 66 per cent) in the early 2000s to about 54 per cent in 2015. Secondly, the contribution of the medium business sector to total tax revenue has remained largely static at about 21 per cent over the 2000-15 period. Thirdly, during the same time period, the total tax revenue shares of the micro and small business sectors have more than doubled: from 1.8 to 3.7 per cent for the micro business sector and from 9.9 to 21 per cent for the small business sector.

As discussed previously, *Paying Taxes* indicators suggest that a mid-size firm in Vietnam typically makes many tax payments to the tax authorities annually and also requires many hours to complete its tax affairs. Further, a Vietnam Enterprise Survey conducted by the World Bank (2017c) in 2015 reveals that a very high proportion of businesses (42.7 per cent) are visited by or required to meet with tax officials. The number of visits would be directly proportional to the required frequency of tax reporting. Such interactions between business taxpayers and tax auditors can often give rise to petty tax bribes.

To the best of the authors' knowledge, there is no publicly announced anti-tax corruption policy in place despite the perception of widespread petty tax bribes.¹⁵ There may be two reasons for such a lack of specific policies. First, as discussed in section 4.3, Vietnam has been doing reasonably well in terms of both tax collection and tax efforts at the national level. Secondly, Vietnam's current business culture seems to exhibit a high degree of tolerance, or even acceptance, of petty tax bribes. This point will be further discussed in the remainder of this section.

5.3 How and why business taxpayers bribe tax inspectors

In this section, we briefly report the findings of Dang et al. (2016) and Nguyen, Ho, Le and Nguyen (2016).

The study by Dang et al. (2016) utilised a qualitative research method. Primary data were collected using a questionnaire-based survey. A random and proportional sampling was applied resulting in an effective sample of 525 household businesses in eight regions of Vietnam (out of 4.09 million household businesses in 2013).

Their key findings on tax corruption are as follows:

1. while the respondents complained that tax officials use their prerogative and authority with a view to demanding more tax payments, bribes often result

¹⁴ The tax revenue share calculations are based on the annual enterprise surveys conducted by Vietnam's General Statistics Office (GSO, 2016) from 2010 to 2015. The surveys employ a combination of samples to collect data on different groups of enterprises. In the most recent survey (2015), about 455,300 enterprises were covered.

¹⁵ There may be General Department of Taxation internal guidelines or practices for anti-tax corruption but the authors are not privy to this kind of information.

from a process of negotiation and collusion rather than extortion. About 70 per cent of the respondents indicated that they always or often colluded with tax inspectors for mutual benefits. Correspondingly, only 11 per cent of the respondents agreed that tax inspectors often harass them for unofficial payments whereas 43 per cent of the respondents disagreed with it;

2. the scale of corruption is petty. About 67 per cent of the respondents stated that the average amount of unofficial payment per inspection visit is one million VND or less (about 45 USD at the April 2017 exchange rate);
3. tax officials, at the commune and district levels, only received 20 per cent and 25 per cent positive ratings from the respondents, respectively;
4. tax corruption is often perceived as a normal cost of doing business. More than 80 per cent of the respondents did not believe that reporting corruption would result in any action whereas 13 per cent admitted their guilt (so that a bribe would be the lesser penalty than a fine).

The theoretical framework of the study of Nguyen, Ho, Le and Nguyen (2016) was based on the institutional theory, rent-seeking approach and resource-based view. It utilised a mixed-modes research method in which the quantitative analysis involved formal hypothesis-testing using regression analyses. Data were derived from firm-level data for 2009-11 drawn from the Provincial Competitiveness Index, conducted by the Vietnam Competitiveness Initiatives and the VCCI, and the annual enterprise survey, conducted by the General Statistics Office of Vietnam.

Their main findings on costs and benefits of tax corruption are:

1. institutional view: firms engage in corrupt activities only to follow the 'rules of the game'. There is a positive relationship between the probability that a firm makes unofficial payments and: (a) the unofficial payments made by other firms in the district; (b) the firm's belief that other firms make unofficial payments, and (c) the firm's belief that negotiations with tax officials are important;
2. institutional view: the hypothesis that unofficial payments are positively associated with transactional benefits of young firms cannot be supported. There is some evidence that unofficial payments seem to increase with the number of visits and the length of each visit for young firms;
3. rent-seeking view: unofficial payments are positively related to growth for firms operating in restricted areas;
4. resource-based view: unofficial payments have a negative relationship with firm efficiency. This harmful effect is normally hidden and not well recognised by firms.

5.4 Firm innovation

In the study by Nguyen, Doan, Nguyen and Tran-Nam (2016), three aspects of innovation were recognised: new product, new process and modification of an existing product. The research utilised a quantitative analysis that involved instrumental variable regression analyses to deal with the endogeneity problem. Secondary data were derived from firm-level data for 2005-11 drawn from the Surveys of Small and

Medium Manufacturing Enterprises, conducted jointly by Vietnam's Central Institute for Economic Management and the Danish International Development Agency.

Key findings on firm innovation:

1. the findings support the 'greasing-the-wheels' hypothesis of corruption;
2. unofficial payments appear to have a positive and significant effect on general innovation, product innovation, product improvement and, especially, process innovation. While the findings are controversial, it is consistent with the 'greasing-the-wheels' hypothesis of corruption and other previous studies. In the absence of formal and transparent institutions, unofficial payments can provide the certainty needed by businesses to innovate.

5.5 Firm performance

The study by Dang (2016) examined three dimensions of firm performance: investment, employment and per capita income. His research analysis was quantitative, involving a Hausman–Taylor estimation method to deal with the endogeneity problem. His data were taken firm-level data 2006–12 drawn from the annual enterprise survey, conducted by the GSO, and the Vietnam Household Living Standard Surveys, conducted by the GSO with technical assistance from the World Bank.

His key findings on firm performance can be summarised as follows:

1. the findings support the 'sanding-the-wheels' hypothesis of corruption. The prevalence and burden of corruption have negative and significant impacts on investment, employment and household income. Thus, tax corruption can substantially undermine the socioeconomic development of the provinces;
2. a 1 per cent drop in the prevalence of corruption would increase private investment by 3.7 per cent, private employment by 1 per cent and per capita income by 1.5 per cent;
3. a 1 per cent drop in the burden of corruption would increase private investment by 6.4 per cent, private employment by 1.8 per cent and per capita income by 2.3 per cent.

Overall, the empirical findings of the above studies suggest that the impact of tax corruption on private sector is indeed mixed as both the 'sanding-the-wheels' and 'greasing-the-wheels' hypotheses can be supported in different contexts. The presence of the vicious circle of tax corruption, and taxpayers' myopic view on the short-term benefits of engaging in tax corruption are serious challenges to policy-makers who are genuinely committed to fighting corruption.

6. MOVING FORWARD: SOME POLICY RECOMMENDATIONS

The present article has attempted to make a contribution to the under-researched field of tax corruption in general and tax corruption in Vietnam in particular. It has discussed the meaning and types, measurement, causes and consequences of tax corruption, presented the evidence on the extent of tax corruption and reviewed the

findings on impact of tax corruption on private sector development, primarily in the Vietnamese context.

The evidence suggests that Vietnam faces a serious tax corruption problem. Petty tax corruption is prevalent, resilient and damaging. Yet the fight against tax corruption to develop a healthier tax culture is such a difficult one for two key reasons. First, at the macro level, Vietnam appears to do very well in terms of tax collection and tax effort. Thus, there is little incentive for tax authorities and tax administrators to move away from the current practice. Secondly, from the business perspective, corruption has created a vicious circle. Firms may lose sight of their business integrity and long-term strategic capacity because of their myopic, perceived benefits of petty bribes that provide some short-term certainties in the presence of inefficient governance.

To effectively fight tax corruption in Vietnam, a suite of both generic and specific reform measures are urgently needed. Like other transition countries, Vietnam needs to push forward with its structural reform. The generic structural reform consists of several dimensions such as marketisation, rule of law and democratisation. These are clearly beyond the scope of both tax policy-makers and administrators, so they will not be further elaborated upon here.

Tax-specific proposals are within the control of tax policy-makers and administrators. In the long term, tax culture is continuously evolving so there should be a deliberate program of education of taxpayers, especially business taxpayers, and the training of tax collectors/inspectors. Needless to say, such an education and training program should be accompanied by a gradual reform of the salary structure of the public sector.

The short and medium-term proposals basically call for the modernisation and simplification of the Vietnamese tax system. The proposed reform measures are set out as follows:

1. first, Vietnam's tax law should be made more certain and unambiguous so that tax inspectors have fewer discretions in interpreting the tax law. The tax law should also be simplified in order to eliminate an important source of corruption. There should also be a greater effort in applying self-assessment in accordance with international practice;
2. secondly, the tax administration process should be simplified so that there are fewer site visits by tax inspectors and so that businesses can comply with their tax obligations more easily. In particular, there should be a more vigorous push for a greater application of digital technology to minimise face-to-face interactions between business taxpayers and tax inspectors;
3. thirdly, entrance to the General Department of Taxation should be based more rigorously on transparent, merit-based examinations. As a supplement, there should be more regular rotation of staff (from one department to another, or from one sector to another, or from one district to another);
4. fourthly, consideration should be given to establishment of a more accessible mechanism of independent tax dispute resolution through which taxpayers who disagree with the GDT can voice their disputes;

5. fifthly and finally, the GDT should consider introducing a formal measure of its productivity as a way to monitor and improve its operation and performance.

The above proposed measures can only work if there is a parallel effort to break the vicious circle of tax corruption among business taxpayers. This typically requires a carrot and stick approach. As mentioned previously, an important component of such a strategy is a thoughtful program to educate both tax officials and taxpayers about the benefits of a healthier tax culture. High-profile prosecutions of a few corrupted tax officials would also be helpful in turning the tax paying culture around. Another helpful development, which may not be entirely within the control of the GDT, is for the Ministry of Finance to guide and assist the progress and growth of a wave of capable and law-abiding tax practitioners in Vietnam.

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