

**University of Regina  
DEPARTMENT OF ECONOMICS**

**SEMINAR**

- SPEAKER:** Monika Cule  
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- DATE:** Friday, February 13, 2004
- TIME:** 3:30 p.m.
- PLACE:** CL 410 (Classroom Building)
- TOPIC:** Corrupt Tax Enforcers and the Unofficial Economy in Transition Countries

**ABSTRACT**

For more than a decade, the countries of Central and Eastern Europe and the former Soviet Union have been trying to transform their centrally planned economy to a market economy. For some of these countries the considerably large unofficial economy has become a serious obstacle for their economic growth and public finances. Bureaucratic corruption in tax and custom administration appears to be an important element in defining the underground economy in some transition countries.

The purpose of this paper is to examine how corruption affects the unofficial economy in transition countries with a particular focus on the unofficial economy that results from tax noncompliance. More specifically, the paper develops a differentiating characteristic model that examines firms' cheating behavior in the presence of corrupt enforcers of tax compliance. The model analyses the incentives of tax inspectors to engage in corruption and firms' cheating activities, as well as the feedback effects between these decisions.

The results support the notion that corruption breeds cheating, which in turn creates more opportunity for corruption in tax collection. In the situation where widespread bureaucratic corruption among tax inspectors perpetuates an unofficial economy, which in turn sustains corrupt practices, intense auditing and large penalties will deter firms' cheating only if cheating and engaging in corruption is very costly for both firms and tax inspectors to undertake. These results have important implications for the public policy to control tax evasion. A crime and punishment approach – i.e., more intense auditing and higher penalties for cheating – alone might not be a successful strategy in controlling the prevalence of informal sector.

**EVERYONE IS WELCOME!!**