SEEJE

Book Review

Transition, Taxation and the State

Edited by Gerard Turley
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reviewed by Elisabeta Jaba*

This book is a remarkable monograph on the issues of budget softness and tax systems in the transition economies. The book presents the results of the research undertaken by the author, Gerard Turley, at the Centre for Economic Reform and Transformation (CERT), Heriot-Watt University, Edinburgh, on *Soft Budget Constraints, Tax Payments Discipline and Tax Collection in Transition Economies*, under the direction of Mark E. Schaffer.

The author starts from the hypothesis that transition countries are characterized by shortfalls in tax revenues as share of national income. The main determinants of such an evolution, as identified by the author, are: budget softness, poor payment discipline, corruption and bribery, ineffective tax administration, poorly designed intergovernmental fiscal relations and low tax capacity and tax effort. The author focuses particularly on the issue of budget softness.

In dealing with tax revenue decline, the author considers that the state is of crucial importance. The analysis of the tax revenue deficit is achieved by using the theoretical approach of soft budget constraint (SBC). The concept of SBC is explained by the author on the basis of four models presented in the economic literature: Kornai's bureaucratic hierarchical model; Dewatripont and Maskin's dynamic commitment model; Stiglitz's gambling banks model; Shleifer and Vishny's politicians and firms model.

The analysis of the SBC differs from the point of view of the economic transition approaches: the *Washington Consensus* approach regards SBC as an exogenous variable, depending only on political will, while *the Institutional–Evolutionary* approach considers that SBC is an endogenous variable of the institutional set-up.

Considering the case studies undertaken and presented in the book, the author finds that the main instruments of budget softness change during the transition pe-

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riod. At the beginning of the transition the main instruments are trade credit arrears and overdue payables to banks, while more recently, banks and trade suppliers have imposed hard budget constraints on firms and customers.

Furthermore, using the SBC framework, the author approaches the tax collection issue in the context of transition and has the merit of conceptualising this issue.

In the presentation of the appropriate methodology for the analysis, the author uses data for the transition economies (central and eastern European countries – *Albania, Bulgaria, Croatia, Czech Republic, FYR Macedonia, Hungary, Poland, Romania, Slovak Republic, and Slovenia* – and former Soviet Union countries – *Armenia, Azerbaijan, Belarus, Estonia, Georgia, Kazakhstan, Kyrgyzstan, Latvia, Lithuania, Moldova, Russia, Tajikistan, Turkmenistan, Ukraine, and Uzbekistan*).

The book consists of seven chapters: 1) Introduction; 2) Tax, Transition and the State: The Case of Russia; 3) Budget Softness and the Russian Enterprise Sector; 4) Tax Arrears and the Romanian Enterprise Sector; 5) Effective Tax Administration in Transition Countries; 6) Tax Capacity and Effort in Transition Countries; and 7) Conclusion.

The first chapter, *Introduction*, offers a comprehensive overview of the economic transition framework and of the SBC concept.

The second chapter, *Tax, Transition and the State: The Case of Russia*, assesses the problem of taxation and of the models of government from the theoretical point view. The author analyzes the relationship between the state and the enterprise sector in the context of Russia and identifies the symbiosis between politics and economics. The systemic crisis of governance contributed to the 1998 Russian fiscal crisis. At the end of this chapter the author prescribes some policies regarding taxation and the role of the state. The appendixes of this chapter present different indexes for the transition countries, used to characterise the progress in institutional development, the quality of governance, state capture and intervention and an overview of the small business sector in Russia.

The third chapter, *Budget Softness and the Russian Enterprise Sector*, presents the analysis of the financial discipline of Russian enterprises, using the results of a survey of 437 Russian manufacturing enterprises, covering the period 1997-1999. After describing the sample and the survey data, the author gives details of the analysis and the main findings. By applying appropriate econometric techniques, the author concludes that suppliers and banks are not willing to extend credit to unprofitable enterprises and, consequently, are imposing hard budget constraints on firms. On the other hand, the government allocates more frequent subsidies to loss-making firms.

The fourth chapter, *Tax Arrears and the Romanian Enterprise Sector*, focuses on tax arrears in the context of economic transition. The author outlines the methodology used for measuring the tax arrears subsidy, which is based on the stocks and flows of tax liabilities. The author states that he has applied this methodology to a database of over 9,000 medium and large non-financial Romanian firms. The results have allowed him not only to conclude that many firms obtain cheap working capital from the government by means of tax arrears, but also to underline the existence of a poor payments discipline problem. The appendixes of this chapter consist of two case studies on unprofitable Romanian firms.

In the fifth chapter, *Effective Tax Administration in Transition Countries*, the author measures the effectiveness of tax administration in transition countries by comparing statutory tax rates with effective tax yields. He establishes a positive correlation between economic progress in the transition countries and effective tax administration. The appendixes consist of data sources for the 25 transition economies, tables and charts for effective/statutory ratios of Value-Added Tax, Social Security Tax and Corporate Income Tax, made by the author.

The sixth chapter, *Tax Capacity and Effort in Transition Countries*, focuses on the issue of tax capacity (potential) and effort (performance). The author applies a tax capacity methodology, favoured by the IMF in the 1970's, to the study of international differences in tax ratios among developing countries and extended to the transition economies. The author's conclusion is that, in transition economies, tax collection has the same performance as in other countries of similar structure and development.

The seventh chapter, *Conclusion*, summarises the main findings of the research concerning tax collection in transition countries. The author identifies significant cross-country differences. As with non-transition countries, taxation is correlated with the economic, political and social dimension.

In overall terms, Turley's book on *Transition, Taxation and the State* offers a clear analysis of the tax administration systems in the transition countries. The book includes a representative variety of studies, methodologies and theoretical approaches, relevant to the transition economies. The author has made a commendable and successful attempt to synthesize the various dimensions of a complex present-day issue. His talent for handling complex issues in a clear, simple manner makes this book an efficient tool for fuller understanding of the issue under analysis.

The accuracy of information, the modern methodology of analysis and the clear style make this book easily intelligible and deserving of a wide readership.