

Comments on “Is Tax Evasion Beneficial to or Harmful for Growth”

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This paper conducts an inquiry into whether tax evasion is beneficial to or harmful for growth. In his model individuals are assumed to be different in terms of their skill in earning income but also in terms of their skill in concealing income from the tax authority. It is shown that the presence of tax evasion will alter the tradeoff for redistribution found by Persson and Tabellini (1994): the higher the tax rate imposed, the larger will be the benefit from redistribution on the hand, but the cost of tax distortion on the other hand, that is, the level of redistribution should be lower; nevertheless, tax evasion may stimulate or retard economic growth depending on the deeper structure of the model such as preferences. The analysis undertaken by the author is well performed and the topic is very much important and urgent. The conclusion of the present paper which makes a sharp contrast with that of Persson and Tabellini appears to be very interesting. I am sure that this paper significantly contributes to our knowledge on the relationship between tax evasion and economic growth, as well as the related literature.

Nevertheless, there are several critical comments from the viewpoint of reality.

- (1) Tax evasion is a kind of illegal activity. The model presumes the following rather extreme behavior of taxpayers: when tax increases occur, people immediately undertake tax evasion activity. Do people always take such behavior in response to tax increases in reality? Usually there are psychological costs or moral constraints to prevent taxpayers from undertaking such illegal activity. If the author wants to investigate the more realistic behavior of taxpayers in response to tax increases, he should model the behavior of *tax avoidance*. The behavior of tax avoidance is a legal

behavior. It is natural to expect that people faced with higher tax rates first take tax avoidance behavior. In reality, there are many examples of tax avoidance. Most of the Japanese small-scale firms tend to report their overestimated production costs to the tax authorities, so that they officially suffer from losses. As a consequence, they do not pay any income taxes or corporate income taxes. Some multinational firms or rich people transfer their incomes to countries where the rates of income and corporate income are very low (the so-called 'tax heaven'). It seems to me that such tax avoidance behavior is more prevalent and a more realistic description of tax papers in response to tax increases.

- (2) In this model a mean voter plays a crucial role in determining the tax rate. In order to do so, he/she must know the benefits from redistribution and the costs of tax distortion. This means that he exactly knows the structure of the central government's budget constraint. However, the central government's budget constraint is very complex and includes numerous budgetary terms. It is in general impossible for him to know its whole structure. He may actively ignore it because such ignorance is clearly a rational behavior due to the presence of huge information costs. For this reason, the assumption that a mean voter knows exactly the structure of the central government's budget constraint appear to be very unrealistic.
- (3) This paper focuses mainly on the behavior of taxpayers, while ignoring the behavior of the tax authorities. However, whenever tax evasion prevails, the tax authorities would take some action against it. For example, the tax authorities may change their frequency of inspection or penalty fees. Moreover, it may demand bureaucrats or members of Parliament to erect new law so as to reform the tax system such as transforming the direct tax system into the indirect tax system (i.e., consumption

taxes). In some context, moreover, the strategic interdependence between taxpayers and the tax authority may matter. Even in growing economies it is highly likely that the tax authorities would change their behavior. Therefore, in order to make the model being a more realistic, the author should incorporate explicitly the behavior of the tax authorities into the model.

- (4) In his model the sign of dk_t/dq_t plays a decisive role in determining whether an increase in the tax rate increases or decreases economic growth. Nevertheless, the author leaves this sign unambiguous, on the grounds that it depends heavily on the structure of preferences. As a consequence, the question whether tax evasion is beneficial or harmful for growth cannot be a priori determined. Nevertheless, this is the main question that the author wants to ask in this paper. Hence, the author should give some sufficient conditions under general utility functions and/or under more specific utility functions in order to identify the sign, which would help readers get more insight under what situations tax evasion stimulates or retards economic growth.