1. INTRODUCTION

1.1 GENERAL

Many countries overhaul their tax systems from time to time. In the Asian region countries like Indonesia, China, Malaysia, the Philippines, Singapore, Vietnam and Thailand have all undergone drastic tax reforms in the last 20 years. The need to fill the government coffers, attract foreign investment and make the tax system more equitable are among the factors instigating these tax reforms.

Leading politicians, key institutions, external advisers, lobby groups and parliamentarians are just a few of the actors initiating or setting the tax reform agenda and influencing the actual reform process. But who truly pulls the strings? And how does this process work in countries with non-democratic governments? Is it different from democratic countries? Moreover, many countries have received the invited and sometimes uninvited assistance of advisers of multi- and bilateral donor agencies. The role of these foreign actors is sometimes controversial and it remains unclear what their actual influence is in these reform processes. And how does their role relate to the idea that without 'local ownership' most reform projects are doomed to fail (Allott 1980; Walle 2005, pp.65-78). The initial tax law reform may look great on paper, but without local ownership who is going to implement and adhere to the new laws? What happens once foreign advisers have gone home?

So who and what truly influences these tax reform processes? That is the key question of this study. The 1980s corporate and income tax reforms in Indonesia and Vietnam are analysed to find answers to this question. The starting point for the analysis is fiscal sociological theory.

1.2 STRUCTURE OF THE STUDY

Chapter one provides a short introduction to the main features of the research. A multi-disciplinary and comparative approach to the definition of the term ‘tax’ is discussed in chapter two. It is often presumed that everybody knows what the term means, but the definitions most commonly used are designed by economists and lawyers. Such definitions only cover a small part of the much broader area of taxation and using them would limit the research conducted for the two case studies. Chapter three gives an overview of the main characteristics of the policy area of taxation and pays special attention to the tax reform processes in the Asian region over the last 20 years. This is important, as it places the two case studies in a broader context. Chapter four explores theoretical approaches to law-making processes, distinguishing between explanatory theories and descriptive frameworks. The chapter concludes with a theoretical model that describes and to some extent explains the various factors that influence tax reform processes, a model that will be applied to the two case studies. Chapter five starts by introducing the main features of Indonesian history, society and political organization. It then describes the corporate and income tax reform of 1984. A similar presentation of the second case study, Vietnam’s corporate and income tax reform of 1989–93, follows in chapter six. Chapter seven compares the two case studies. Are there any general conclusions we can draw?
Who and what influenced the two reform processes? Does the theoretical model work in both case studies? Does it explain the different influences? Can it be used for other case studies? And if not, what are the limitations of the model and can we adjust it to make it more relevant for other case studies?

1.3 Case studies

The study focuses on the corporate and income tax law reforms of Indonesia and Vietnam in the 1980s. It largely excludes from consideration the actual implementation of these laws since a serious study of this would involve questions, methods and data quite different from those relevant to the study’s key theme: who and what influences the shaping of these tax reform processes? However, understanding the process of change does require some assumptions about the practical relevance of the tax laws designed and approved by the parliaments in both countries. In Indonesia, for example, it is not uncommon that laws are drafted and approved by parliament but never implemented. This is not the case with the tax laws investigated in this study. They have been implemented and significant amounts of revenue have been generated since their adoption.

Little research in this area has been done in developing countries let alone in Southeast Asia. In selecting the case studies it was important that they both involve countries in the Asian region in roughly the same time period and involving the use of foreign advice. Sufficient information had to be available in order to conduct meaningful research. Both Indonesia and Vietnam decided to overhaul their tax system in the 1980s. Indonesia made this decision in the early 1980s when it realised that its oil revenue would be declining, resulting in revenue shortage in the short-to-medium-term future. Vietnam decided to do so in the late 1980s as part of a market reform policy that jeopardised its traditional revenue derived from state-owned enterprises.

Both countries have been subject for long periods to foreign rule that have importantly influenced their bureaucratic systems. Vietnam was occupied by Chinese and French rulers (and to a lesser extent by Americans). Indonesia was colonised by the Dutch.

Both countries believe they have to operate in a competitive international environment to attract foreign capital. They adopted policies in their tax reforms specifically designed to attract foreign capital and be competitive in the Asian region. Furthermore, both countries made the choice to use tax legislation as a tool for social and economic change.

Both countries used and still use the services of foreign advisers to assist in the drafting of new tax legislation as well as in implementing tax laws. Advice has been received from multilateral aid agencies, such as the World Bank and the International Monetary Fund (IMF), and from bilateral international organisations. Indonesia received the most assistance from a team from the American Harvard Institute for International Development (HIID). Vietnam received assistance from various foreign organisations, including the Swedish aid agency, SIDA (Swedish International
Development. Cooperation Agency). During the Indonesian income tax reform process, a HIID team was invited by the Indonesian government to give assistance. The HIID group had been in Indonesia since the early 1960s and had expressed its concern over the sources of government revenue. However, the group did not get much support for its position until the Indonesian government realised that it faced severe problems due to declining oil revenue. It was only then that the government gave Harvard *carte blanche* to go ahead with proposals for major tax reform. The HIID team (mainly consisting of economists) was involved in revising tax policies, giving technical advice regarding the different taxes, and the actual drafting of the new laws. Formally, the Ministry of Finance (and the Tax Department of this Ministry) had final responsibility for the reform process, and the Minister of Finance played an important role.

The quite drastic tax reform process in Indonesia is in sharp contrast with the much more deliberate tax reform process in Vietnam. Consensus was required from a range of ministries, the drafting of tax laws and their final approval by the national assembly took many years, and proposals as well as laws were subject to frequent and major changes. Vietnam has received tax advice from many different international organisations, including the World Bank, IMF and Asian Development Bank, HIID, but most importantly from the Swedish aid agency SIDA. SIDA’s role largely involved technical rather than policy advice. The SIDA team were mainly tax administrators from the Swedish Tax Revenue Department.

In summary many factors, some similar, influenced the initiation and shaping of their respective tax reform. But which factors were determining their respective processes and were these factors the same for both countries?

It is important to emphasize that in the years since the tax reform processes of the 1980s and early 1990s in Indonesia and Vietnam, much has changed in the tax laws of both countries. However, the key questions in this thesis have not thereby become outdated. This thesis aims to develop a model for understanding differences in tax reform processes based on the two case studies, a model that will be valid and applicable long after the developments studied have ceased to be relevant.

### 1.4 RESEARCH QUESTIONS

**Key Question**

**Who and what influenced the different stages of the tax reforms in the 1980s in Vietnam and Indonesia?**

This question addresses the central theme of the study: the groups and interests influencing public policy in regard to tax reform in the two countries. Who influenced these reforms?
Sub-Questions

1. What factors led to the initiatives to overhaul the existing tax laws in Vietnam and Indonesia in the 1980s?

The factors that lead to a reform initiative may play a role in who or what influenced the reform (Campbell and Allen 1992; Campbell 1993). Most studies in the area of tax reform emphasise economic factors as the main factors responsible for change. Other factors include geopolitical conflict (Campbell 1993), or electoral politics and the ruling party’s central objective of staying in office (Ecleston 1998).

2. Who were the key actors involved and which groups or interests did these actors represent? Why and how were particular groups successful in influencing the reform?

Who were the key players in the reform process. Observing that particular groups were influential is important. But, where it is possible to say anything about it, the ultimately interesting question with broader theoretical and practical implications is why and how certain groups were able to exercise power.

3. More specifically, what were the influences of foreign advisers in the legislative tax reform?

Most developing countries, including Indonesia and Vietnam, use foreign advisers to assist them with their tax reform. And many bilateral and multilateral aid agencies believe that they can play an important role in advising countries, developing countries in particular, on economic policy including their tax policy. The fact that they are so frequently used in these reforms, combined with the delicate issue of ‘local ownership’ as a prerequisite for success (Walle 2005) explains the detailed attention paid to this ‘interest group’.

4. What role did international factors play in shaping parts of the tax reforms?

The actors involved in the reform in both case studies often invoke international factors such as globalisation and international competitiveness in support of lowering corporate and income tax rates and in favour of tax incentives. How sound are such claims, and what role do they actually play in fiscal decision making?

1.5 Methodology

The research involved a combination of literature research and in-country fieldwork. The literature research included local newspapers, archives, journals and magazines as well as internal memos issued by various government departments and foreign
actors such as domestic ministries of finance, Asian Development Bank, IMF and the World Bank.

The fieldwork included interviewing key decision-makers and key advisers in the tax reforms in both countries. Where possible, the names and nature of the interviews are mentioned in footnotes on the relevant pages throughout this study. Fieldwork in Indonesia was mainly conducted in the period 1993–98 and in Vietnam 1995–98. Country specialists were also interviewed to put the reforms into perspective. Interviews were conducted with historians, political scientists, anthropologists, economists and lawyers who have particular expertise in Vietnam or Indonesia.

Obtaining information on the reform in Indonesia proved to be much easier than in Vietnam. As is explained in the Vietnam chapter, difficult access to information is a challenge faced by many researchers and relates to the unique features of the Vietnamese socialist government structure.

2. THE DEFINITION OF TAX

2.1 INTRODUCTION

Many contemporary social, economic and political studies in the area of taxation do not give any attention to the definition of the term ‘tax’. Apparently it is assumed that everybody understands what the word ‘tax’ means. It is important to distinguish between tax and taxation. Taxation refers to the act or practice of imposing taxes or the fact of being taxed. Taxation can also refer to the revenue gained from taxes. For our research we focus on the definition of ‘tax’ rather than taxation. This chapter discusses various definitions of ‘tax’ and their often overlooked shortcomings. Such discussion is crucial to our analysis of the case studies of tax reform in chapters 5 and 6. As these case studies will demonstrate it is impossible to explain the reforms with the help of the generally used definition of tax.

Comparisons between different tax systems in different countries also require a workable definition of the term ‘tax’ and other terms related to this such as tax burden and tax ratio. Statistical analysis and international tax comparisons are made almost impossible due to the different classification of tax versus non-tax revenue (as touched on by Bird (Bird 1991). Nevertheless, statistics on tax burden, distribution of tax burden, and tax revenue, that make use of very limited definitions, are often used as a foundation for advice on tax measures in developing countries. One only has to

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5 This chapter has been published in slightly different form in Heij, G. (2001). "Definition of tax in the Asian context." Asia-Pacific Tax Bulletin 7(4). The 1911 edition of the Encyclopaedia Britannica defines taxation as “That part of the revenue of a state which is obtained by compulsory dues and charges upon its subjects”.