

# E-Government and Its Impact on the Informal Sector in Turkey

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## INTRODUCTION

In recent years Turkey faced with large budget deficits. After the financial crisis in 2001, budget deficits had reached a critical level. In order to deal with the problem, Turkish government have taken some actions to increase its revenues and to reduce its expenditures. The government has been working with the IMF to bring about structural changes and governmental reforms. As a result, a stabilization program has been put in place under IMF directions. Also, Turkey is currently in the negotiation process for EU full membership. The implementation of e-government is seen as a large step in governmental reform and another step towards EU standards.

E-government was introduced as one of the ways to increase tax revenue collections, which has been a major problem causing the deficits. The study is focused on e-taxation which was introduced as a way to effectively collect taxes which are the most important revenue resources of the government. Another focus is on the informal sector of the economy (or underground economy). In Turkey, efficient tax collection system is needed because of non-collection from its large informal sector. Gerxhani (2004) reported the average size of this sector in developing countries to be as high as 44% of GNP in Africa and 35% in Asia. This sector has also been significant in the Turkish economy as well. Therefore, the target for higher rate of tax collections comes from this sector of the economy.

Informal sector is a very important area to investigate because it inhibits productivity, discourages business investment and has the potential to reduce economic growth (Capp et al., 2005). According to a study by OECD (2006) of Turkish economy, a major factor which caused a relatively low GDP per capita is its low level of productivity, especially in the informal enterprises. Informality therefore reduces the overall growth potential of the Turkish economy. We expect that the implementation of e-taxation has significantly increased tax revenue collections coming from the informal economy. The following section presents a brief review of informal economy.

## REVIEW OF INFORMAL ECONOMY

The informal economy is a vague, multidimensional and interdisciplinary concept therefore, it is necessary to define the borders of the areas under investigation. In this study, we take similar interpretations from the OECD report (2005) on informal economy as the unobserved economic activities that are driven by tax evasion or by attempts to avoid legal standards and procedures. Therefore, it excludes criminal activities and non taxed activities such as domestic labor. According to this definition, registered businesses in informal sector may keep substantial parts of their earnings unrecorded and evade substantial tax payments. This group includes, for example, self-employed businesses, restaurants and traders whose tax amounts depend on their declarations. Tax evasion behavior exists in some businesses and in all sectors of the economy, however, the magnitude of informality depends on the special structure of that sector (Sarili, 2004). For example, in those sectors where auditing is difficult to implement such as small companies serving individuals and labor-intensive sectors, business owners are more likely to hide their real earnings.

There is a positive correlation between tax rates and the level of informal economy. The higher tax rates in developing countries, with respect to developed countries, lead to larger informal economies (anonymous, 2001). Another significant incentive for informal economy in Turkey is the presence of high value added tax rates. This often leads to undocumented trade by increasing the propensity of purchasers towards bargaining for not taking the receipts. Thus, it should be expected that

such bargains will reduce when the VAT rates are lowered. The European Union, is planning to harmonize the VAT practice. In the process of joining the EU, the VAT rates in Turkey will have to be aligned with these regulations.

Some of the primary economic reasons to participate in the informal economy related to unemployment and inflexible formal labor market; high tax rates and low audit probabilities; a declining real price of capital; the governmental over-regulation of the formal or market sector; and the high cost of formal production (Gerxhani, 2004). In Turkey, a large number of employment opportunities has been in the informal sector because the formal sector has been unable to absorb the growing labor force, especially in the urban area. Also, the Turkish labor market is over-regulated with very high taxes on labor, both of which serve as a large disincentive to formal sector employment (OECD, 2006).

Additionally, weak legal and law-enforcement systems contribute to the high percentage of informal economy. Tax amnesty programs has been put in place several times over the years in Turkey. They seem to encourage tax evasion and informal economic activities. Under the expectations of the next amnesty, taxpayers postpone their tax payments. This has been possible because of lack of effective tax auditing. According to the Ministry of Treasury statistics, the number of tax auditors in the last 17 years declined by 68%. From 1985 until 2001, the population in Turkey grew from 50.3 million to 68.6 million, that is 36.4%. Thus, while the population grew, the number of auditors reduced, which implies that both the frequency of tax auditing and the number of audited taxpayers has been reduced. It can be concluded that the government has been unable to collect a large portion of tax revenues. Over the recent years, the Turkish government has concentrated on borrowing, thus, it indirectly encourages those taxpayers to continue their informal activities. As a result, the internal and external debt of the country has been large.

## ANALYSIS OF E-TAXATION AND INFORMAL ECONOMY

Kertesz (2003) proposes that governments need to evaluate their e-government projects for the economic value using cost-benefit analysis (the net present value method) since hundreds of millions of dollars are spent on such projects. Picci (2006) propose a structural modelling approach to analyze the economic impact of e-government. Others such as e-government readiness report (available at <http://www.unpan.org/e-government5.asp>) assesses UN member states to ascertain how willing and ready the governments are to use ICT to improve the access and quality of basic social services to the people for human development. Curtin (2006) offers a framework for e-government model and measurement. In this research, the authors attempts to explore e-taxation issues and its impact on informal sector by using various measurement methods, for example, econometric models, monetary approach and production of electricity approach. Specifically, it is expected that there has been an increase in tax revenues collected by the government after the implementation of e-taxation, and the revenues have come from previously undeclared informal economic activities. Comparison will be made from data gathered before and after e-taxation implementation. The authors will offer analysis, conclusions and recommendations based on results from various measurement methods.

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