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Digitalization – The Impact on Tax Evasion and Sustainable Development: Case Study of Asian Developing Economies

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Abstract

Most nations make an effort to combat and lessen tax evasion. The key to financing sustainable development is raising domestic revenue through taxation. The central aim of a tax policy in a developing market economy is to raise sufficient revenue equitably with minimal distortions. In most developing Asian countries, India included, the deployment of taxes is geared towards the achievement of many objectives besides raising revenue. The lack of simplicity in the tax systems has seen a majority of these countries complicate their tax systems by setting up preferences and exemptions to prioritize the achievement of some objectives. The overall effect of such approaches is uneven tax burden, with the ultimate beneficiary becoming foreign multinationals at the mercy of domestic companies as a majority of countries in the Asian belt persistently continue to extend a myriad of incentives to attract incentives with a particular focus on foreign investors. Due to the unprecedented health, social, and economic crises, countries have lately been recording enormous losses of revenue. There has been a remarkable rise in big data that has permitted cross-checking of relevant information pertaining to taxpayers. Imperatively, the volume of global data from online marketplaces, electronic cash registers, mobile payment providers, and other digital sources is expected to triple by the end of 2024. This has allowed tax administrators to easily review digital transactions and audit the digital trail that is often left by online transactions. This guarantees increased revenue which could spur economic growth, be reinvested in environmental sustainability, and create independence among countries.

Keywords: Tax evasion, developing Asian countries, digitalization, sustainability, carbon emissions, economy growth
Jel codes: H20, H26, O44, O53, Q53

1. Introduction

Taxation is a critical component of fiscal policy lying at the heart of the society, constituting a monumental impetus for sustainable development (Uyar et al., 2021). For the acceleration of a country's economy, it is imperative for governments to be proactive in creating an enabling environment by providing physical and social infrastructure and ensuring the inclusion of the vulnerable and weak businesses in the economic transformation of the country. Considering the developing economies in Asia, the majority of the population, around 40%, are between 0-14 years age group, implying that there is an urgent need to direct much of their investments to education, social services, and healthcare (Kuriyan, 2018). Furthermore, most of these countries have limited spaces for borrowing because of the low or negative balances of trade, with debts exceeding 70% of the Gross Domestic Product (GDP). Substantive resource mobilization remains the primary way of raising the revenue required for essential public investments in social and physical infrastructure. Due to these conditions, revenue collection remains the only reliable option for governments to collect money to backstop the financing of these investments.

However, the realization of this goal has become a mirage for the giant Asian economies due to tax evasion and avoidance. Over the past decades, the issue of tax evasion, particularly in the Asian economies, has received considerable attention because its exploration is pertinent to the sustainable development of economies (Nguyen & Luong, 2020). The tax systems of Asian economies are gravely confronted with the menace of tax evasion. An economy battling with increasing levels of tax evasion is likely to exhibit a low investment mix in essential public goods and services, implying low economic growth and poorly managed public enterprises. The tax evasion menace has widened the gulf between the actual revenue collected and what ought to be collected had systemic failures in the tax policy been addressed (Islam et al., 2020). The governments of the giant Asian economies have for quite some time now been lamenting of the widespread incidences of tax evasion by companies and other taxable persons as they have evidently employed tax avoidance strategies, fraudulently evaded taxation, and at times connived with tax officials through bribes by exploiting loopholes in the tax system (Nguyen & Luong, 2020). It is worth noting that these occurrences bear monumental challenges to the Asian economies as they have substantively distorted public investments that could have otherwise created a conducive environment for economic activities.

Payment of taxes remains among the most challenging and time-consuming interactions between citizens, businesses, and the government. The central aim of a tax policy in developing market economies is to raise sufficient revenue equitably with minimal distortions. Scanning the tax systems of the giant Asian economies, there is an urgent need for a review of the current tax system because they have loopholes that are exploited by companies and individuals who undervalue, exempt some of their assets for tax purposes or even connive with government tax officials through bribes, and other fictitious economic operations like the establishment of offshore companies, "ghost companies" and associated enterprises resulting in unimaginable distortions and low productivity that consequently result into a low tax-GDP ratio (Audi, Ali & Roussel, 2021).

Raising revenue by minimizing the costs associated with taxation (collection cost, distortion costs, and compliance costs) is the most fundamental objective of any tax policy since evidence abounds in, as asserted by Benkraiem et al. (2021), that people and organizations in economies that have come up with innovative and functional tax policies significantly adjusted their behavior in response to new tax policies. However, it has been established that to minimize compliance and administrative costs, a well-functional tax system should be transparent and simple, with clear objectives to solely raise revenue equitably. Therefore, to raise the desired revenue with lower rates of taxes, it is cardinal to broaden tax bases with minimum preferences and exemptions to a section of the economy and develop and install an intelligence system coupled with effective administration should be put in place to ensure compliance. In this vein, it is imperative to adopt tax policy reforms that enhance long-term revenue productivity rather than pursuing reactionary reforms through ad hoc changes to meet short-term exigencies (Ahluwalia, 2019). Employing this strategy will not only enable governments to move towards a broad base but would also install a simple and transparent system of tax that avoids arbitrary differentiation of tax across economic activities and people.

2. Literature Review

In most developing Asian countries, India included, the deployment of taxes is geared towards the achievement of many objectives besides raising of revenue. Lack of simplicity in the tax systems has seen a majority of the developing Asian economies complicate their tax systems through setting up preferences and exemptions to prioritize the achievement of some of these objectives, for instance, increasing investments in certain sectors, augmenting infrastructure, increasing savings and investment levels, increasing production to ameliorate exports to specifically spur the development and growth of small and medium-sized industries or protecting them from foreign competition through tax breaks or reduced tax rates, and pursuing strategies geared towards attaining balanced regional development (Audi et al., 2021). Even if the assigned objectives are implicit, it is still unclear how the effectiveness of such objectives can be ascertained, rendering them redundant and catalysts of complicating the tax system, hence only opening up avenues for tax evasion and avoidance. The overall effect of such approaches is uneven tax burden with the ultimate beneficiary becoming foreign multinationals at the mercy of domestic companies as a majority of countries in the Asian belt persistently continue to extend a myriad of incentives to attract incentives with a particular focus on foreign investors, a move that not only results into significant loss in revenue from tax expenditure but equally distorts the allocation of resources.

However, the primary challenge to the developing countries in Asia has been designing a tax system that is capable of incorporating fairness in its medium-term and long-term effects (Lea, 2018). Moreover, the most instrumental lesson that can be drawn from optimal taxation is that tax distortions soar exponentially with the rates of taxes. This implies that even if taxes are seen to be progressive, the adverse impacts on employment and economic activity could negate the progressivity, and much attention to the fairness of taxes to individuals in an economy ends up being misplaced. Designing a tax system to reduce distortions may contain a number of individual-based taxes that could be perceived as regressive, yet what matters is the impact of the tax system as a whole rather than the effect of individual taxes on income distribution.

Nearly all governments globally endeavor to enhance the collection of taxes and tax compliance as an overarching matter of necessity to collect sufficient revenue for financing essential public goods and services (Rekova et al., 2018; Ashford et al., 2020). Through taxation, governments are able to get revenue for education, health care, investment in infrastructure, social care, research, and environmental protection. As a result, there are a number of reasons why tax policies in the Asian economies should be reviewed. First, the ratio of tax to GDP in most developing countries has stubbornly remained stagnant despite a myriad of attempted reforms over time. Second, the motivation for reforming the tax system stemmed from the desire to ameliorate public investment in infrastructure and increase budget allocation for other sectors like health care and education that are essential for realizing the potential of the population. Additionally, there has been a widespread series of conflicts between tax collectors and taxpayers in recent years, underscoring the need to not only reform tax administration but also develop a system that is geared up to the best global tax practices to address the menace of base erosion and profit shifting (BEPS) often synonymous with multinational companies.

Due to the unprecedented health, social, and economic crises that the world is currently going through, countries have lately been recording enormous losses of revenue. Critically evaluating the economic arena, companies and individuals are remarkably digitalizing their operations and making transactions online (Hai, Van & Thi Tuyet, 2021). This has majorly been attributed to the COVID-19 pandemic, which led to a boom in digital commerce (Priyono, Moin & Putri, 2020). Furthermore, there has been a remarkable rise in big data, a cardinal factor in the shift since it easily permits cross-checking of relevant information pertaining to companies and individuals, further enhancing compliance by taxpayers (Zhu & Zhu, 2021). Imperatively, the volume of global data from online marketplaces, electronic cash registers, mobile payment providers, online banking systems, and other digital sources is expected to triple by the end of 2024.

The rapid growth of e-commerce has been an impetus to digital transformation, which is projected to increase remarkably by 2025, making it an increasingly vital section of the tax base (Kumar, 2020). The soaring use of cashless payments through mobile phones and online banking, among others, has equally been instrumental in powering digital transformation. Consequently, tax administrators can easily review such transactions and audit the digital trail that is often left by online transactions (Wanjagi & Ruto, 2020; Santoro et al., 2022). Digitalization, as reported by Terada-Hagiwara, Gonzales, and Wang (2019); Roy and Khan (2021); Lagodiienko and Yakushko (2021), smoothens the process of tax collection by easing the administrative burden for officials, giving them more time to focus and deal with higher-value activities. It also allows authorities to demystify and simplify bureaucracies in tax collection, hence reducing the compliance burden on taxpayers and substantively reducing the compliance costs in revenue collection. For instance, research on the case study of South Korea indicates that digitalization has managed to cut compliance costs by over 19% between 2011 - 2016 after digitalizing its tax system (Bellon et al., 2019; Roy & Khan, 2021). It is on this backdrop that this study sought to evaluate the impact of tax system digitalization on tax evasion, economic growth, and environmental sustainability in developing Asian economies. Despite the aforementioned benefits, fast-tracking digital transformation in many countries is up against enormous challenges. Research, as reported by Davenport and Westerman (2019); Wimelius et al. (2021), indicates that most of the investment initiatives undertaken in the area of digital transformation since 2018 have not been encouraging, as a total of close to $900 billion out of $1.3 trillion spent have not shown encouraging return on investment (ROI).

To this end, a successful tax system is one that keeps the expenses of administration, compliance, and distortion to the economy to a minimum. It should have a simple structure, a broad base, low marginal rates, and less differentiated rates. Individual taxes should not be used to determine whether a tax policy is fair overall. Additionally, the goal of fiscal policy should change from lowering inequality to eradicating poverty, which can be accomplished more successfully by using the budget's spending side. A thorough goods and services tax is a crucial element of a sound tax structure. Focusing only on the tax structure's design is insufficient; developing skills and knowledge in tax administration is just as crucial. A robust information system underpins a good tax system, helping to both enforce the tax and calibrate changes with complete knowledge. The taxpayer service is the hallmark and sign of good tax administration since it increases compliance and fosters trust among taxpayers. The use of information technology in taxation encourages transparency and offers good data for tax enforcement.

3. Data & Methodology

The current study will greatly help the livelihood of populations in developing countries in Asia. The project explored the influence of utilizing digital technologies on preventing tax evasion and enhancing economic and environmental sustainability in developing nations. The study aimed to help these Asian nations to address problems associated with illicit financial flows, economic and environmental degradation. This information will help them understand the importance of embracing digital technologies in handling the said issues. Additionally, the study hoped to boost the current literature on technology utilization in empowering authorities that manage

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taxes. Therefore, the study will not only play a role in curbing tax evasion but also, in a greater manner, cultivate populations' economic empowerment.

3.1.Hypotheses

Digitalization has negative and positive impacts on the environmental transformation of businesses. Upon domination of the former, it obstructs businesses' green transformation owing to crowding out of resources valuable to sustainability. Nevertheless, when the latter takes control, it will greatly benefit sustainability due to its ability to enhance economic and environmental performance. Since digitalization produces benefits gradually, the risky part of it will be more compared to the benefits during the early stages, but as time goes on knowledge buildup effect and incorporation of resources will gradually appear, and the positive effects will exceed the risky effect with time (Laukaitytė, 2022). From the above assessment, the first hypothesis can be;

H_1: Digitalization has greatly reduced emissions and increased forest cover, thus increasing environmental sustainability

H_2: Introduction of digital technologies in taxation has contributed to reduced tax evasion

H_3: Digitalization is the *main driver of economic growth in developing Asian nations.*

H_4: The developing nations ought to collect more revenue with improved digital capacity in the next two years.

3.2. Methodology

To restrict unlawful financial flows like tax evasion, the usage of digital technologies has arisen as one of the ideal approaches, among other ways, to enhance environmental sustainability. This will assist nations in collecting funds for efforts geared toward economic development, environmental sustainability, and poverty reduction. The presence of defenseless financial systems contributes to less tax revenue causing inhibited social and economic growth.

The current study chose a descriptive research design to explore a relationship between a developing nation using digital technologies and the reduction of tax evasion. The study explains how relocation from traditional trading methods to digital ways has facilitated tax evasion in developing nations which are often considered to have been affected by weak regulations resulting in the loss of important revenue streams. To achieve the objectives of the study, secondary data from the World Bank Data.

The study targeted the top five Asian developing nations using secondary data collected by World Bank. The countries included China, India, Indonesia, Malaysia, and Vietnam. Since the population's sample size appeared large, random sampling was employed to narrow the various nations to 5. Most selected nations included those that have greatly embraced digital technologies.

The data was obtained from published data from the individual republics and the World Bank website (The World Bank Data, 2020). In projecting the amount of revenue, these countries ought to collect with improved digitalization in the next two years. The 2023 data was utilized as the base year for this study with a projection to developing nations embracing digital avenues assisting them to achieve greater revenues beyond in the next two years. In general, the World Bank data was mainly used in establishing the republics that recognized a revenue increment by adopting digital approaches. Thereafter, plausible conclusions were made from the obtained data.

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4. Results and discussions

H1: Digitalization has greatly reduced emissions and increased forest cover, thus increasing environmental sustainability

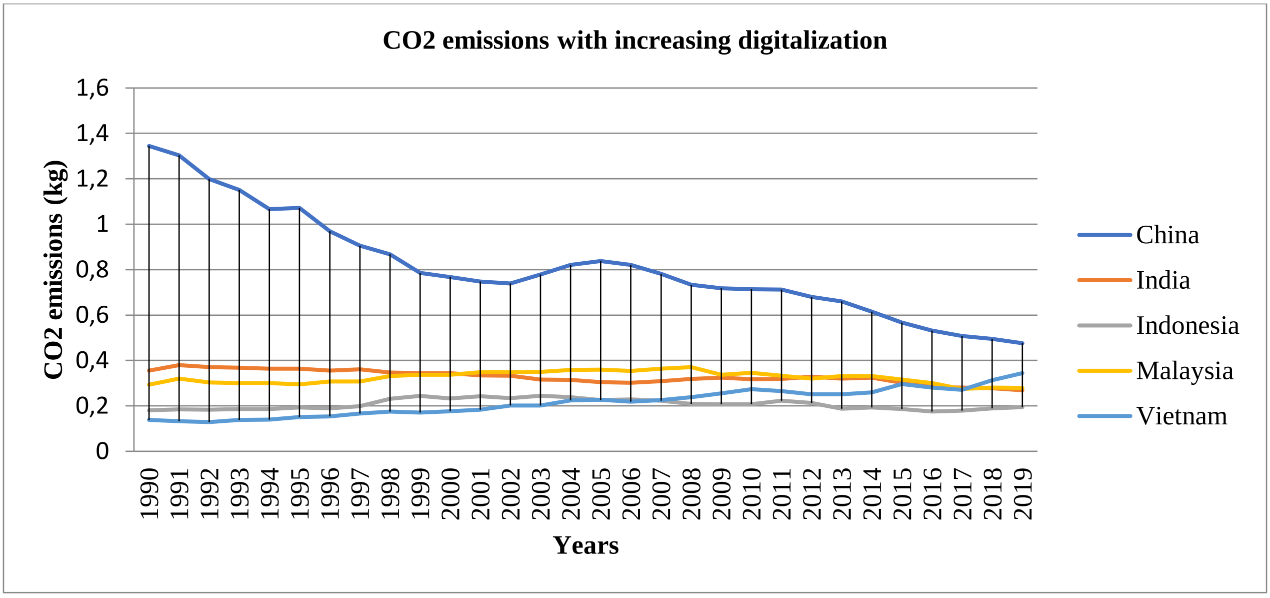

Figure 1. CO2 emissions with increasing digitalization

Based on the above figure, digitalization has greatly decreased carbon emissions, especially in China. The country is currently undergoing high-scale development, and in order to achieve dual carbon goals, low carbon emission is of great importance (Hepburn *et al.*, 2021). The findings above show that digitalization has both substantial impacts on carbon emissions and the growth of the digital economy, a number of countries demonstrated a complete adoption of the digital economy and its role in carbon emission, and as a matter of fact, they are putting much emphasis on low carbon development. Digital economy development has a diverse effect on carbon emissions; its effect on carbon emission reduction is more relevant. In conclusion, there exists a relationship between carbon emission and the digital economy and how it is affected by green energy efficiency.

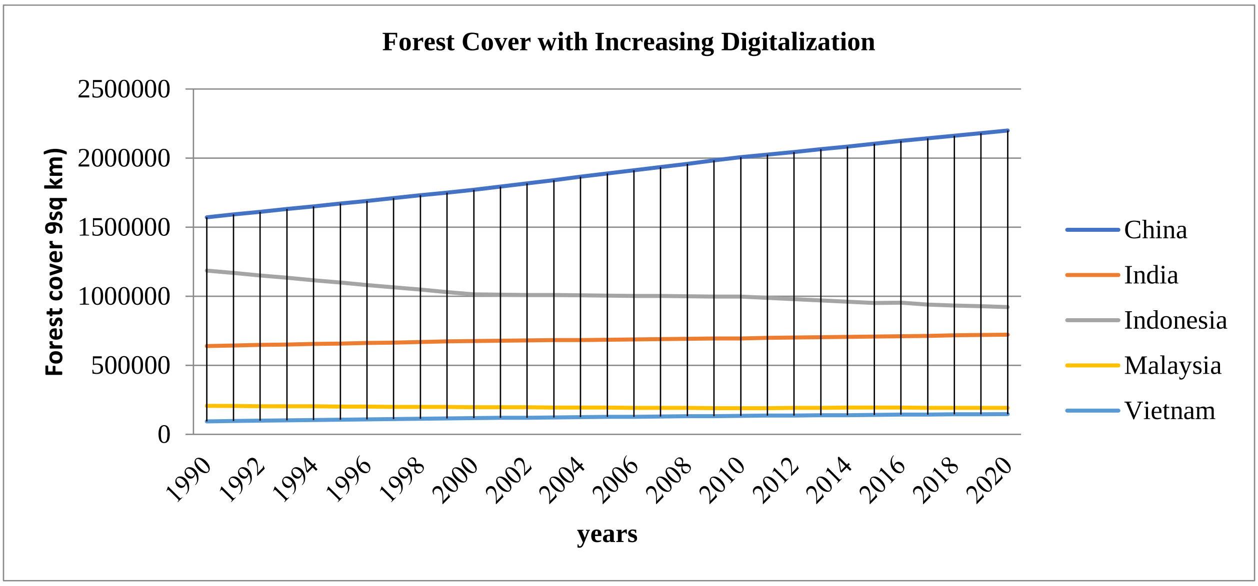

Figure 2. Forest Cover with Increasing Digitalization

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Digitalization has greatly increased forest cover, particularly in China and Indonesia. China contains the fifth greatest forest area worldwide, and a slight modification in China's forestry growth will have unavoidable effects on international ecological sustainability (Weins *et al.*, 2022). The nation has experienced extreme natural forest logging and also made incredible determinations in afforestation within the last 50 years (Jinlong, 2022). Its forest area is currently undergoing various changes, and the implementation of a number of forestry programs in driving forestry transitions has been done. The main objective of these measures is to defend forests' ecological services and sustain the development of the country's forestry. The programs cannot be implemented effectively as they are spatially sophisticated; therefore, a number of digital approaches like remote sensing, geographic information systems, and forest modeling have been useful in managing the varied information in the country's forestry. In China, digital forestry is both practical and beneficial in the development of the forest area. The transformation from analog to digital avenues of protecting forest areas is projected to result in the great success of forestry evolutions in China.

H2: Introduction of digital technologies in taxation has contributed to reduced tax evasion

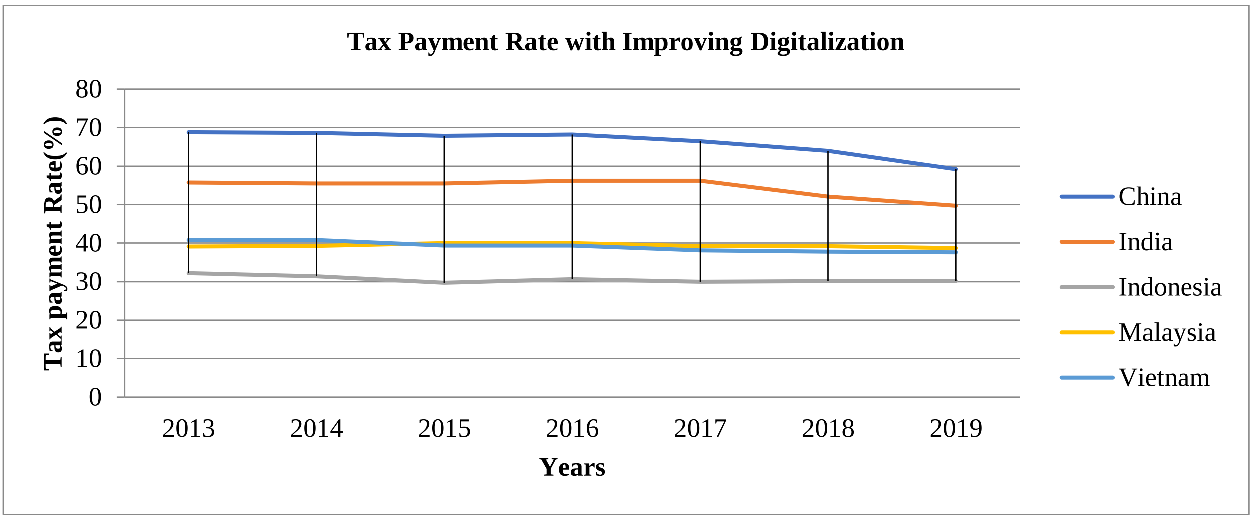

Figure 3. Tax Payment Rate with Improving Digitalization

Based on the finding, the rate of tax payment has decreased throughout the years, and this means there is tax evasion. This could have contributed to corrupt individuals who seek to bypass digital systems and cryptocurrencies (Kaplan, 2021). With the development of digital technologies, these sectoral players can easily avoid tax liability by significantly reducing within the bases. Due to this, the pressure shifts to low-scale taxpayers, who end up compensating for the revenue loss.

H_3: Digitalization is the main driver of economic growth in developing Asian nations.

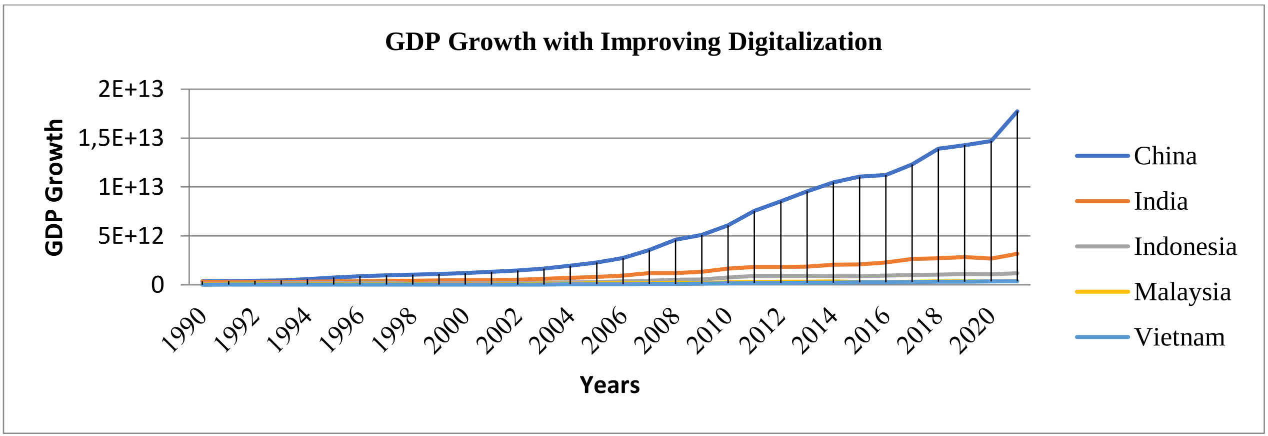

Figure 4. GDP Growth with Improving Digitalization

The findings show an increasing GDP growth rate throughout the years in all the countries, with China revealing the highest. This nation has positioned itself as a global leader in the digital economy. Whereas the digitalization of developed economies is still low, China has outshined the rest of the world in the new digital economies (Konstantopoulos *et al.*, 2022). The key factors that spur this growth are government policies that provide a conducive environment for the digital economy in a number of booming industries. Over the past years, the digital infrastructure significantly improved, and this is in tandem with emerging economies. In order to allow innovation, the Chinese government has adopted a lean regulation at the early stages of development. Tentatively, the adoption of digital technologies can boost productivity, observed on a growth accounting basis. A noticeable feature of the digital era is that information has become a new production factor.

The use of digital approaches has created many job opportunities in new sectors. This flourishing of e-commerce industries has enhanced the creation of job opportunities in China. For instance, within the e-commerce sector, Alibaba's podium has close to 11 million Small and Micro Enterprises, which have produced over 30 million employment opportunities over the past ten years (Aymar, 2019).

H_4: The developing nations ought to collect more revenue with improved digital capacity in the next two years.

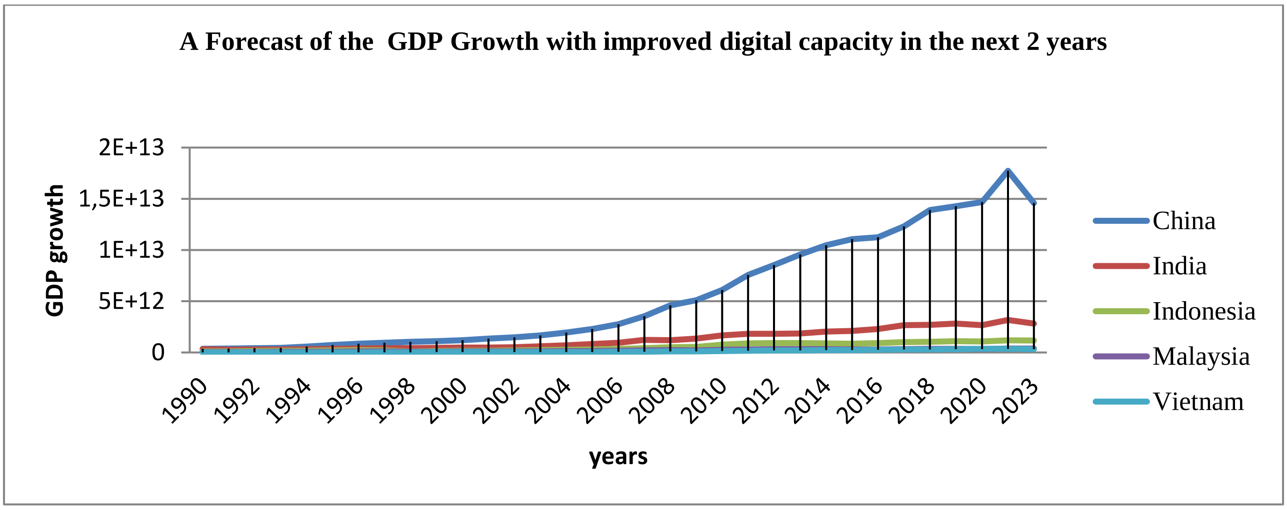

Figure 5. A Forecast of the GDP Growth with improved digital capacity in the next two years

From the above forecast, it is evident that revenue collection will decrease with gradual increasing digital capacity in the next two years. This finding can be attributed to the capacity of digitalization to replace low and medium-skilled jobs. In various nations, adopting digital technologies has increased economic growth rates and enhanced the quality of services delivered. Nevertheless, for a nation to obtain the most out of the adoption of digital approaches, it requires stronger procedures guaranteeing competition between businesses and the employees' skills adjusted to the modern economy demands (Hanna, 2018). A positive impact resulting from digitalization can only be attained after an accomplishment of a full-fledged collaboration between technology and other components of economic growth. Development of other features has to be warranted to enable economic development via digitalization.

5. Conclusion

The study has investigated the mechanism of the effects of carbon emissions on the adoption of digital technologies. It has measured the digital economy growth indices of 5 top Asian developing nations between 1990 and 2018. The study concluded that digitalization has greatly decreased carbon emissions, especially in China. The findings further show digitalization as the *main driver of economic growth in Asian developing nations.* GDP growth rate has been noticed throughout the years in all the countries, with China revealing the highest. This denotes that digitalization is becoming a greater GDP component in various Asian developing countries. These countries lie all along the income band, and consistently, the regions have the greatest dispersion in terms of digital approaches adoption. It is then evident that technological advancement can bring massive benefits by improving productivity.

Finally, the introduction of digital technologies in taxation has contributed to increased tax evasion. In an ideal situation, technological adoption enables effective and workable tax reforms, guarantees appropriate digital economy taxation, and lessens compliance obstacles. In contrast, the study findings revealed a significant decrease in tax payments throughout the years, which means tax evasion still exists within the Asian developing nations despite the advanced digitalization.

To have the desired results, it is important for the digitalization of tax systems to enlist a broad collaboration of stakeholders with a multidisciplinary team to provide funding and make the necessary legal reforms. In collaboration with stakeholders, the multidisciplinary team should focus on ensuring value through simplifying procedures and ensuring that taxpayers are permanently shifted into e-payment, e-filing, and e-document ecosystems. The value could be measured through reduced compliance costs, higher compliance by taxpayers, and increased tax certainty. Moreover, the tax reforms should be geared towards changing the culture of managing processes to data management, where tax administrators should primarily concentrate of getting the right data to minimize errors in taxpayers' files and ensure that returns are not just prefilled with any data from banks. Last but not least, it is of paramount importance for tax administrations to develop interoperable and scalable systems capable of being used in the field, across departments, and at the tax headquarters. To ensure this is attained in the developing Asian economies, the World Bank is spearheading initiatives to backstop the efforts of administrators on digitalization and automation of tax systems, a move that significantly benefits dozens of countries, businesses, and citizens alike.

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