

**REGULATING INDONESIA'S HIGH WEALTH  
INDIVIDUAL TAXPAYERS: IDEAS FOR  
POLICY TRANSFER**

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# Declaration

I declare that this thesis is my own original work. This thesis is account of research undertaken between July 2010 and July 2014 at Regulatory Institutions Network (RegNet), The Australian National University (ANU), Canberra, Australia.

I certify that this thesis does not incorporate without acknowledgment any material previously submitted in whole or part for a degree in any university and that to the best of my knowledge and belief it does not contain any material previously published or written by any other person except where due reference is made in the text and/or in the references.

A handwritten signature in blue ink, appearing to read 'Sekti Widihartanto', with a horizontal line underneath it.

.....

Sekti Widihartanto

2014

# Acknowledgments

*You'll get there, Sekti...*

(Professor Valerie Braithwaite, said at the end  
of many discussions in my office at RegNet)

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# Dedications

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# Abstract

A growing challenge for tax authorities worldwide is managing the tax compliance of high wealth individuals (HWIs). The OECD promotes comparative policy learning as an approach to addressing such shared problems. It also gives its imprimatur to ‘best practice’ for OECD countries wishing to strengthen their regulatory frameworks. Among OECD recommendations are for tax administrations to invest in specialised HWI initiatives. While such initiatives have gained popularity, this thesis presents evidence to suggest that the divergence of tax regulatory practices and policies can reduce the transferability of such policy lessons and practices.

Indonesia, despite its developing status and the relative immaturity of its tax administration, adopted a HWI initiative in 2009. This thesis investigates the process of this transfer and, in particular, its implementation in the Directorate General of Taxation (DGT).

The policy transfer framework of Dolowitz and Marsh (1996; 2000) was used as the theoretical starting point for the thesis. The notions of ‘uninformed’, ‘incomplete’, and ‘insufficient’ transfer provided by the framework, however, are terms too broad for understanding processes that may lead to failure. A process approach, as advocated by Christensen (2013), Eccleston (2006), Radaelli (2000) and Sharman (2010) was needed that could take account of multiple, competing processes, some of which assisted the



HWI office, others which undermined it. Braithwaite and Drahos' (2000) concepts of actors, principles, mechanisms, and webs of influence were applied to disentangle the dynamics that occurred at the implementation stage of the transferred policy.

Evidence of implementation processes and consequences was collected through an empirical case study of HWI taxation regulatory arrangements in Indonesia and Australia. Australia was the single most important advisor to DGT on establishing a HWI unit. In all, 54 semi-structured interviews were conducted with Indonesian and Australian tax officials and other relevant actors between September 2011 and April 2013. Archival material and public documents were also analysed.

Policy transfer occurred with a political imperative to 'do something' to modernise the tax administration. The policy was adopted voluntarily by Indonesia, with support sought and received from the international epistemic community. Within Indonesia and DGT, however, there was no opportunity for negotiating the time frame for the HWI initiative. There was little time for deep learning.

In the early stages, DGT invested in training and dialogue to build a shared commitment among staff and stakeholders around the functions of the HWI unit. After three months, the DGT's direction on how it managed compliance of the HWI taxpayers changed dramatically. The old DGT ethos of meeting revenue targets was imposed on the HWI unit. During this second period of the HWI unit's operations, webs of dialogue took second place to webs of control. Coercion undermined the process of building commitment to the new HWI unit. Blocked communication channels prevented cooperation. Resistance emerged – among stakeholders, to the idea of a HWI unit, and to a return to old tax collection practices by those who favoured reform. For the

moment, the contest of principles for Indonesia's tax system, and control of mechanisms to realise these principles, has led to a crushing of HWI tax reform.

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# List of Abbreviations and Acronyms

AIP	Australia Indonesia Partnership	IFI	International Financial Institution
AIPEG	Australia Indonesia Partnership for Economic Governance	IGT	Inspector-General of Taxation (Australia)
ANAO	Australian National Audit Office	IKPI	<i>Ikatan Konsultan Pajak Indonesia</i> (Indonesian Tax Consultants Association)
ANU	Australian National University	ILO	International Labour Organization
AR	Account Representative	IMF	International Monetary Fund
ATO	Australian Taxation Office	INP	Indonesian National Police
AUSTRAC	Australian Transaction Report and Analysis Centre	IP	intellectual property
AusAID	Australia Agency for International Development	IRS	Internal Revenue Service
BAS	business activity statement	ITD	International Tax Dialogue
BCE	Before Common Era	LBI	Large Business and International business line (ATO)
BISEP	Business, industry, sociological, economic and psychological (drivers of compliant and non-compliant behaviours)	LTU	Large Taxpayers Unit
CATA	Commonwealth Association of Tax Administrators	LTO	Large-taxpayers Tax-service Office (DGT)
		LTRO	Large-taxpayers Regional Office (DGT)

CCER	collection cost efficiency ratio	MNC	Multinational corporation
		MNE	Multinational enterprise
CCO	Counselling and Consultation Office (DGT)	MoF	Ministry of Finance (Indonesia)
CEO	Chief Executive Officer		
CHPG	Closely Held Private Group	MTO	Medium-taxpayers Tax-service Office (DGT)
CIAT	<i>Centre Interaméricain des Administrateurs Fiscaux</i> (Inter-American Centre of Tax Administrations)	NGO	Non-Government Organisation
		NPM	New Public Management
CIT	Corporate Income Tax	OECD	Organisation for Economic Cooperation and Development
CSA	Child Support Agency (UK)		
CRR	comprehensive risk review (ATO)	OMC	Open Method Coordination
		PIT	Personal Income Tax
CSES	Child Support Enforcement System (US)	PRR	preliminary risk review (ATO)
CTSI	Centre for Tax System Integrity, ANU	PSBR	Public Sector Borrowing Requirement (UK)
DFAT	Department of Foreign Affairs and Trade (Australia)	RI	<i>Republik Indonesia</i> Republic of Indonesia
DGT	Directorate General of Taxation (Indonesia)	Rp	Rupiah
DPCR	Directorate of Potential, Compliance and Revenue (of DGT, Indonesia)	R&D	Research and Development
		SARS	South African Revenue Service
DPR	<i>Dewan Perwakilan Rakyat</i> House of Representative (Indonesia)	SBY	Susilo Bambang Yudhoyono, Indonesian President
DSS	Department of Social Security (UK)	SGATAR	Study Group on Asian Tax Administration and Research
DTT	Double Taxation Treaty		
EC	European Commission	SME	Small and Medium / Small-to-Medium Enterprise

EU	European Union	SOE	State-owned enterprise
FAD	Fiscal Affairs Department (of the IMF)	SOP	Standard Operating Procedures
FTA	Forum on Tax Administration (of the OECD)	SR	specific review (ATO)
GDP	Gross Domestic Product	STO	Small-taxpayers Tax-service Office (DGT)
GFC	global financial crisis	TIF	Tax Increment Financing
GIS	Geographic Information System	TNC	Trans-national Corporation
HMRC	Her Majesty's Revenue and Customs (UK)	TWOP	Tax Work-Off Program
HNWI	High Net Worth Individual	TSO	Tax Service Office
HOTSA	Health of the System Assessment (ATO)	UN	United Nations
HWI	High Wealth Individual	US, USA	United States of America
IDB	International Development Bank	UNESCO	United Nations Educational, Scientific and Cultural Organization
IGO	International Governing Organisation <i>or</i> Inter-governmental Organisation	VAT	Value-Added Tax
		WCPN	Windsor Conference Policy Network

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# Introduction

*Governments may imitate what peer countries do simply because they are peers, or governments may imitate what apparently successful countries do simply because they are high-status countries that are considered to know best.*

Meseguer (2005, p. 73)

## **Background to the study**

In March 2009, in front of Indonesia's wealthiest people and hundreds of other guests (Adamrah & Suharmoko 2009), Indonesian President Susilo Bambang Yudhoyono (SBY) declared the establishment of an institutional arrangement within the Indonesian tax administration dedicated to very wealthy individual taxpayers. The unit was named the High Wealth Individual Tax Service Office (HWI TSO). The unit started operating on May 1, 2009. This initiative was designed to assist HWIs in fulfilling their tax obligations (Directorate General of Taxation [DGT] 2009). It was a campaign promise made a few months before when the President faced the Indonesian people in an election to extend his presidency for another 5 years (Sherlock 2009). This policy,

however, had been planned one year earlier as part of the President's 'quick-win' initiative, wrapped in a bigger rhetorical slogan of 'bureaucratic reforms'.<sup>1</sup>

At the same time, in the last quarter of 2008, the global financial crisis (GFC) led to the Indonesian government anticipating a decline in tax revenue from corporate taxpayers (Djaja 2009). The history of the Indonesian tax system was that it relied heavily on revenue from corporate income taxes: more than 80 per cent of total income tax revenue was contributed by this sector (Nugraha & Lewis 2013). Most big corporations in Indonesia relied on international markets for their profits (Djaja 2009). The GFC reduced profits, which in turn reduced their tax payments. Therefore, tax revenue from individual taxpayers became of greater interest to government and the Indonesian tax system, after being neglected for a long time. The switch to personal income tax was regarded as useful in the eyes of policymakers for two reasons. In contrast to income tax revenue from corporations, which fluctuated with global economic conditions, personal income taxes were relatively stable, at least in the short term.

The second reason for the interest in personal income tax was that Indonesian policymakers recognised that in countries with mature tax systems (i.e., more developed economies), personal income tax constituted a relatively larger proportion of tax revenue (Arnold 2012). As shown later in this thesis, there is potential to collect more tax from individual taxpayers in Indonesia. In the early years of the 21st century, it was estimated that registered individual taxpayers constituted only 27 per cent of individuals who should be registered in the system (Marks 2003). In a more recent study of the

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<sup>1</sup> The quick-win initiative was a series of programs proposed by government institutions in which the benefits could be felt instantly (in less than one year) by the program stakeholders (Indonesia Ministry of Administrative and Bureaucracy Reform 2011).

Indonesian tax system, Brondolo et al. (2008, p. 15) concluded that ‘only a very small fraction of the taxpayer population was registered with the DGT’.

High wealth individuals became the first target in the Indonesian government’s effort to make individual taxpayers the major source of public revenue rather than corporations. The DGT defines HWIs as those who (a) are corporate shareholders and principal business owners; (b) have financial asset and property at least Rp10 billion (US\$1 million); (c) reported taxable income at least Rp1 billion; and (d) whose domicile is in Jakarta (International Monetary Fund [IMF] 2011, p. 8).<sup>2</sup>

In order to achieve this goal, the Indonesian tax authority (Directorate General of Taxation, or DGT) decided to adopt a regulatory model that had been known to work elsewhere to increase compliance of HWIs. The idea of establishing an appropriate structure in tax administration to deal specifically with HWIs had been promoted by the Organisation for Economic Cooperation and Development (OECD)’s Forum on Tax Administration (FTA). A special HWI regulatory model had been adopted in countries such as Australia, Canada, France, Ireland, Japan, Mexico, the Netherlands, New Zealand, South Africa, the United Kingdom, and the United States (OECD 2009a, p. 56). It is of note that most of the countries that have adopted a HWI<sup>3</sup> unit are more developed countries and mature democracies.

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<sup>2</sup> The threshold amounts of net worth vary across countries. For instance, Australia has a threshold of A\$30 million (Australian Taxation Office [ATO] 2008); in the United Kingdom the threshold is £20 million (HM Revenue & Customs 2010); and in New Zealand the threshold is NZ\$50 million (Inland Revenue 2012).

<sup>3</sup> 'HWI' is pronounced as 'hui', with a silent h, instead of 'ach də-bəl-yü ī'; that is why the article 'a' is used prior to this abbreviation rather than 'an'.

When Indonesia decided to go down the same route as more developed countries and adopt a regulatory model that increased HWI tax compliance, the DGT received assistance from the International Monetary Fund (IMF) and the Australian Taxation Office (ATO) to establish a HWI unit. DGT learnt from its counterpart in Australia how to manage tax compliance among HWIs.

Despite the fact that the HWI regulatory arrangement is regarded as an effective way to maximise tax compliance by the very wealthy (OECD 2009a, chap. 3), the HWI unit did not meet the expectations of DGT's leaders. In February 2012, only 34 months after its inception, the experiment was called to a halt: the HWI unit's formerly exclusive focus on the administration of taxes for affluent individual taxpayers was broadened to administering taxes for state-owned enterprises (SOEs). The unit's name was also changed following alteration in its functions.

In this thesis, the argument for the failure of the HWI policy has been made on 'programmatic' grounds rather than 'political' grounds (Bovens 2010).<sup>4</sup> It should be acknowledged that SBY did win his second term of office with his quick-win policy promise of which the HWI unit was part, although public endorsement had waned by the end of his second term. The argument for failure on programmatic grounds, however, focuses on other non-political questions (Marsh & McConnell 2010, p. 571): Did the policy achieve its intended outcomes? Was the policy an efficient use of resources? Was the policy made operational in a way that was consistent with achieving its objectives?

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<sup>4</sup> See also Bovens et al. (2001) for the distinction between programmatic and political dimensions of success and failure in public governance.



The HWI unit was unsuccessful in that it did not achieve its policy objectives. It did not succeed in collecting more tax from wealthy people or substitute the traditional revenue dominance of corporate income tax in the Indonesian budget with personal income tax. Located within the Large Taxpayers Regional Office (LTRO) portfolio<sup>5</sup>, the HWI unit, in its two full years of operation<sup>6</sup>, contributed only 0.24 per cent on average of total revenue collected by the Office.

The failure of the HWI unit in Indonesia gives rise to the question of why the policy did not work as expected in spite of a significant investment of resources. The initiative had the support of the President, advice was provided by the IMF and Australia, and DGT sent their staff to Australia to learn how to set up and operate such a unit. DGT developed a new office, assembled their best staff and located them together in Jakarta. The investment, however, was not enough to enable the HWI unit to increase tax payments from HWIs. The unit was regarded as inefficient from a collection cost-efficiency ratio perspective (DGT n.d., p. 6).

Indonesia's HWI unit did not allow for the holistic monitoring of tax compliance of HWIs and their entities. Only through a holistic monitoring approach, in which a HWI and her/his related entities were treated as an integral economic entity, could there be any hope of collecting more tax and shifting the balance of tax contributions from corporations to individuals, in particular to individuals who controlled corporations.

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<sup>5</sup> In terms of revenue, the LTRO has been contributing significantly to the Indonesian state budget. Consisting of only four tax service offices (TSOs) including the HWI unit, the LTRO contributed almost 38 per cent of the total DGT revenue for fiscal years 2007–2011 (DGT 2012).

<sup>6</sup> That is, for the fiscal years 2010 and 2011. For fiscal year 2009, the unit was yet to be given any revenue targets. For fiscal year 2012, the structural change which saw the HWI unit merged with large enterprises (i.e., state-owned enterprises or SOEs) occurred in the middle of the fiscal year, which meant that the revenue for the new unit included revenue from SOEs.

Indonesia's HWI unit targeted wealthy individual taxpayers but not their entities when assessing compliance.

This thesis investigates the reasons why a policy shown to be effective elsewhere in the world for managing tax compliance of HWIs did not meet its potential when it was transferred to Indonesia.<sup>7</sup> The purpose of my research was to investigate the processes that Indonesia undertook to establish a HWI unit, and through this analysis, ask the question of whether transfer of HWI policy, or of other tax policies, can be undertaken in ways that improve the likelihood of success. The more generalised challenge of my thesis was to identify a set of processes for the successful transfer of a tax policy such as a HWI policy from elsewhere. A process is defined as 'a series of actions or steps taken in order to achieve a particular end' (Stevenson 2010).

## **Research problems and aims**

The approach taken to investigating the reasons for the HWI policy's shortcomings in Indonesia was located within the research field of policy diffusion and transfer. This research tradition examines why policies used in one country or region are taken up in other countries or regions, a particularly puzzling question in my research because the originating country for modelling and learning about the policy, Australia, is so dissimilar from the adopting country, Indonesia.

Generally speaking, policy diffusion and transfer are likely when there is dissatisfaction with local conditions and public institutions have limited resources to deal with this

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<sup>7</sup> This refers to increasing tax contributions from high wealth individuals as mentioned above but also to a broader potential to alter Indonesian's attitudes towards individual taxation, starting with Indonesia's wealthy taxpayers and then extending the idea of individual taxpaying tax to other income earners.

dissatisfaction (Rose 1993). Authorities then look to other governments or non-governmental organisations to search for solutions to common problems (Evans 2004a; Rose 1993). Learning from or even copying others' solutions is cheaper than developing a solution from scratch. But the process of implementing a policy transferred from other countries may take a different form, as was the case when the Indonesian tax authority decided to adopt a HWI project based on Australia's model. This is particularly likely when policy and institutions are adapted from a jurisdiction with a different level of economic development, political structure, culture, and legislative and regulatory infrastructure (e.g., Evans 2009). This gave direction to the main research question that I sought to answer: Why did the HWI initiative in Indonesia fail to build a cooperative relationship with high wealth individual taxpayers, lift tax contributions from high wealth individuals and prepare Indonesia for growth in the individual taxpaying sector?

In examining policy implementation one also needs to understand the forces driving the policy agenda (Eccleston 2006, p. 4), because they will affect the way in which the policy is carried out. Accordingly, in this research I collected considerable background information on the originating and adopting countries and the steps they took to progress the policy, from setting the policy agenda through implementation.

In order to answer the main research question mentioned earlier, I posed a series of more specific questions:

- How was the HWI unit set up in other countries, specifically Australia, prior to Indonesia adopting this policy? How was the HWI unit in Indonesia set up?
- Who were the instigators and designers of the unit and who was recruited to work in the unit (actors)?

- What was the purpose and priority of the unit (principles) and how was it to achieve its objectives (mechanisms)?
- How was the effectiveness of the HWI unit helped or hindered by being included or excluded from webs of influence inside and outside DGT?
- How has the process in setting up the HWI unit affected policy outcomes?

The policy transfer literature was useful in showing the deliberativeness (Evans 2006) associated with the establishment of a HWI unit in Indonesia. Indonesia wanted to be a modern state, and a HWI unit was perceived to be state-of-the-art in tax administration because of its distinctiveness in monitoring tax compliance of HWIs and their related entities (Braithwaite & Braithwaite 2001; Hong & Braithwaite 2011). Other countries' tax offices had shown that an HWI-specific unit could work well in eliciting cooperation and effectively monitoring taxable income (OECD 2009a; 2013b). The policy transfer literature was also useful in emphasising the importance of processes in the transfer of policy (Eccleston 2006; Radaelli 2000; Sharman 2010). In Indonesia's case, processes of implementation of the policy will be shown to be critically important to its failure. There was some indication of policy learning, but also signs of superficial learning, even emulation. In order to understand these processes and the different currents that were influencing how events unfolded in Indonesia, I adapted a model of principles, mechanisms, actors, and webs of influence from Braithwaite and Drahos' work on global business regulation (Braithwaite & Drahos 2000) and used it to guide the analysis of interview data and other materials. Nine propositions emerged to explain why the HWI policy did not translate successfully into the Indonesian context.

The first three propositions are extensions of ideas from the diffusion and transfer literature on when and why one country adopts another's policy. These propositions explain the limited success of Indonesia's HWI initiative.

**Proposition 1:** Structural compatibilities are necessary between the transferring and adopting country in terms of legislation, regulations, frameworks and codes of practice for tax administration. These elements, if compatible, provide tax system integrity. Incompatibility in these elements risks undermining tax system integrity. Importing a new initiative without checking structural compatibility and effects on integrity is a high risk process.

**Proposition 2:** Physical compatibilities between the transferring and adopting country in terms of geographical features, population size, means of record keeping and information sharing determine the degree to which a transferred policy must be adjusted and modified to suit the adopting country's circumstances. Importing a new initiative without planning for adjustments will introduce disruption into the transfer process.

**Proposition 3:** Cultural compatibilities from a broader societal perspective between the transferring and adopting country require consideration before a decision is made to transfer a policy. In particular, attention should be paid to how much respect is afforded to the tax system in the two countries and how much trust placed in authorities. A program needs to be accepted if it is to be implemented successfully.

The remaining six propositions emerged primarily from researching processes of implementation using a principles, mechanisms and actors framework. These

propositions describe the steps that need to be taken to give a new program such as the HWI unit the best chance of working effectively.

**Proposition 4:** Adoption of a new program requires an analysis of how the rigidity of the structure of the current organisation might obstruct implementation of a new program.

**Proposition 5:** Adoption of a new program requires knowledge of the overarching principles for the organisation that coordinate action and give meaning and purpose to actions.

**Proposition 6:** Adoption of a new program requires a generous time frame and repeated educational encounters to ensure the organisation develops familiarity with the program, is comfortable with the change, and learns how to operate the program effectively.

**Proposition 7:** Adoption of a new program requires vertical and horizontal communication in order to reach all parts of the organisation to explain the purpose of the new program, how it is to operate and the resources available to help it operate.

**Proposition 8:** Adoption of a new program requires continuing dialogue across the organisation and with those outside the organisation to respond effectively to problems in implementation and to ensure continuous learning about how to operate the program more effectively.

**Proposition 9:** Adoption of a new program requires acknowledgement of resistance within the organisation and opportunity for dialogue with those who wish to express that resistance to improve the operations of the program.

This thesis presents the journey of discovery of these propositions.

## **Outline of the thesis**

This thesis comprises eight chapters.

Chapter 1 provides a review of the literature on policy transfer and its comparison with other closely related concepts, notably policy convergence and diffusion. These concepts are examined within the context of globalisation. The works of David Dolowitz and David Marsh (1996; 2000) and the analytical framework they developed were used as a basic guide for a policy transfer analysis of the HWI unit. Several studies in taxation that used policy diffusion and policy transfer concepts are reviewed in this chapter using the Dolowitz and Marsh framework. Few studies in taxation focus on the actual implementation process and how it fails internally (notable exceptions are Christensen's (2013) and Sharman's (2010) works). Exploring a tax policy implementation phase systematically within a policy transfer framework is the contribution of this thesis to the literature.

In my review of the literature on policy transfer (Chapter 1), I recognised different pressures at the international, national, and organisational levels, from the 'decision to transfer' phase through to the 'implementation-practice' phase, that determine the success or otherwise of policy transfer. Pressures of different kinds in different spheres of government activity have an effect on the depth of learning that takes place. At some levels, learning and deliberation may be taking place, while at other levels emulation and 'doing something' (Sharman 2010) may be the best that can be offered in support of the new program. Appreciation of these different kinds of pressures and unevenness in the depth of learning is necessary to understand the fate of the HWI unit in Indonesia.

In Chapter 2 I delve further into the question of implementation in policy transfer by employing the concepts of ‘principles’, ‘mechanisms’, ‘actors’ and ‘webs of influence’ (Braithwaite & Drahos 2000). These concepts were used by John Braithwaite and Peter Drahos to explain the processes of globalising business regulation: Different *actors* employ different *mechanisms* to push for or against particular *principles*. This model opens the analysis to understanding complementary processes and conflicting processes at the implementation stage. Organisations are not homogeneous entities. Some members of DGT supported the HWI initiative, others opposed it. These differences play an important role in explaining how policy initiatives unfold and their ultimate success.

In particular, Chapter 2 explains how different interpretations of a policy’s principles by different actors in privileged positions can change the implementation process. Webs of influence are used by powerful actors to promote certain principles; they can enable persuasion and dialogue or they can be used to control relationships and the means for achieving certain outcomes. Webs of dialogue and control were mechanisms that enabled some practices to gain ascendancy while others are disestablished. Of relevance to later data analysis is the way in which webs of control gained importance to re-establish old practices, with subordinates directed by powerful actors to achieve policy objectives as new practices were dismantled.

Chapter 3 contains a description and explanation of the research methods employed in the study. Empirical fieldwork was conducted in Indonesia as the primary focus of the study, but also in Australia. The ATO had a HWI Taskforce and was the country that provided most advice and guidance to DGT in setting up their HWI unit. In both countries, the method for data collection was two-fold: interviews and document and



archival analysis. Interviews were conducted with tax officials and stakeholders from inside and outside the tax authority to elicit their understanding of the policy and seek their views and analysis of aspects of the HWI policy: its appropriateness, its potential, positives and negatives in implementation, supportive and non-supportive elements, and challenges and opportunities. Documents were obtained from a variety of sources. Some were publicly available, others were obtained by request. I collected and analysed formal government papers, reports from inter-governmental organisations, academic reports and research papers, and media releases and reports.

Interviews and documents and archival analysis were used in two basic ways: first, to understand how the HWI unit should be operated and provide the best possible account of the functioning of the HWI unit, and second to describe the expectations surrounding the HWI unit and what happened in practice.

The first part of Chapter 4 provides a detailed description of the features of the HWI initiative in Australia, with particular attention to tax compliance management. The chapter includes a discussion of the *Taxpayers' Charter* (ATO 2010) and the ATO compliance model (ATO 2009) and how the *Charter* and the model were applied to tax authority-taxpayer relationships and to managing tax compliance of HWI taxpayers in Australia. The model serves as guidance for the ATO to provide taxpayers with a proportionate and appropriate response to compliance issues, based on their understanding of taxpayer's individual circumstances. The *Charter* serves as the basis for the cooperative, trusting, and respectful relationship between the Tax Office and the Australian public (Braithwaite & Reinhart 2000, p. 1).

In the second part of Chapter 4 I discuss the HWI regulatory arrangement within the ATO, with particular attention to the influence of the policy principles, the mechanisms

used to achieve those objectives, the roles that various actors played in implementation and how coordination across the organisation was achieved. I contend that it is crucial to understand the elements of the Australian tax system that underpin the operation of the HWI program as part of learning how this policy works, before attempting to transfer the policy to another jurisdiction. Importantly, there was a gap between Australia and Indonesia in relation to these elements that contributed to unsuccessful transfer.

Chapter 5 provides evidence to demonstrate that policy transfer had occurred in Indonesia in relation to the HWI initiative. Indonesia's HWI unit was intentionally adopted after examining what other countries had been doing to improve the tax compliance of wealthy individuals. Indonesia did not arrive at the policy without consultation and information from other countries facing similar problems.

Chapter 5 also describes the operation of the Indonesian tax system to illustrate the context that led to the adoption of the HWI policy. The relevant features of Indonesia's tax system are: low tax burdens and high non-compliance; a tax system driven by revenue targets and not interested in individual taxpayers; a taxpaying culture dominated by disengagement with the tax system; and tax administration that is geographically dispersed, rigid and hierarchical (with headquarters controlling operations).

Chapter 5 illustrates the structural rigidity of DGT in adopting the HWI unit that contributed to its failure. As the organisation was inflexible, it could not accommodate the unit as a new initiative with high status and high priority. Structurally the HWI unit in Indonesia was placed at a level which made it difficult for the unit to coordinate its role with that of others. In contrast to the ATO's HWI Taskforce, Indonesia's HWI unit

faced impediments when dealing with taxpayers, other parts of DGT, and other institutions. Therefore, understanding and assessing the rigidity of the structure of the current organisation is vital for adopting countries when wanting to implement a new policy from elsewhere.

The implementation phases of the HWI unit in Indonesia are discussed in Chapters 6 and 7. In Chapter 6 I show how actors in leadership positions in DGT interpreted policy ideas differently, setting different priorities for DGT, and favouring different mechanisms in terms of networks and strategies to achieve policy objectives. This chapter illustrates the significant differences in the approaches and mechanisms of two leaders of DGT at two different points of time during the implementation of the HWI unit. The difference in mechanisms used by different actors was caused by different meanings given to the policy by the leaders. Mechanisms incorporated the networks cultivated to advance policy implementation (coercive and controlled versus open and discursive) as well as specific strategies such as developing databases for taxpayers and staff retention.

Chapter 6 also describes time pressures and how a longer time frame was not given to staff so that they could try to develop new taxpayer databases and develop knowledge and expertise. The implementation of new 'foreign' policies requires a reasonable time for the policy to be fully understood and bedded down and to implement new practices.

Communication among actors plays an important role in disseminating policy ideas from the top to the bottom of an organisation, and in channelling new ideas and feedback, to benefit policy implementation from the bottom up. Continuing communication can only be maintained through the use of dialogic webs: that is, webs of influence that allow actors to share their ideas. Webs of control, on the other hand,

utilise rewards and punishment to elicit compliance from subordinate actors and do not facilitate the open flow of communication.

In Chapter 7 I demonstrate that the use of webs of control, rather than webs of dialogue, by powerful actors diminished opportunities for actors on the ground to participate in the policy implementation process, to suggest feedback, and contribute new ideas based in their 'grounded' knowledge. Most importantly, poor communication resulted in lack of support for the policy and deteriorating trust among actors. Dialogic webs offered the prospect of sustaining the commitment and mutual understanding of shared interest among actors (Braithwaite & Drahos 2000, chap. 23). Powerful actors could have elicited commitment and mutual understanding from internal and external stakeholders through continuing dialogue.

When trust in leadership deteriorates, resistance to change is very likely to occur. Nevertheless, a degree of resistance is always likely during the process of implementing a new policy. The problem with Indonesia was that resistance to change was not anticipated when the country implemented the HWI initiative in its tax administration. Resistance is the main theme of the conclusion of the thesis, provided in Chapter 8. This chapter argues that the HWI initiative in Indonesia failed because a range of factors posed obstacles to implementation, which when unresolved, fomented resistance. The obstacles included institutional, human capital, and social capital barriers.

# Chapter 1

## Globalisation, Policy Diffusion and Policy Transfer

*...rapid diffusion within the world system seems linked to the homogeneous cultural construction of contemporary nation-states... they provide fertile ground for the rapid diffusion of public policies and institutional structures. States subscribe to remarkably similar purposes...*

(Strang & Meyer 1993, p. 491).

### Introduction

It is not new for one polity to learn practices and approaches from another. Such learning can be traced back as early as 315 BCE, when Aristotle advised the rationality of lesson-drawing from other's experience elsewhere (Evans 2004a) and studied the different ways in which Greek cities were governed in order to learn how to create the best political system (Rose 2005). The international proliferation of Value Added Tax (VAT)-style consumption taxes in the later decades of 21st Century, after being introduced in France in the early 1950s (Eccleston 2006), and the establishment of large taxpayer units (LTUs) within tax administration structures dedicated for managing tax compliance of large corporations since early 1980s (Baer 2002), are other examples of

policy transfer. In the last few decades, rapid advancement in communication, information and transportation technologies combined with the internationalisation of politics have intensified global sharing of ideas and practices. Globalisation has reduced barriers to economic, political, and cultural exchange between societies (Drezner 2001).

Scholars (e.g., Bernstein & Cashore 2000) distinguish *globalisation* from *internationalisation*. The former has an economic focus on ‘increasing economic transactions that transcend borders’, while the latter concerns ‘the increased activities and influence [on states] of actors, ideas and institutions from beyond state borders’ (p. 70). Even with this shade of difference in meaning, both terms are relevant in this thesis. Both refer to the domestic elements (politics, economy, culture, or policies) of one country becoming more and more influenced by and integrated with other countries, leading to policy similarities.

Similarity in policy between countries can be achieved in many ways. Bennet (1991) described four processes that lead to a global convergence of policy and that entail different kinds of agency on the part of the state: *emulation*, where state officials copy other countries’ actions; *elite networking*, where convergence is facilitated by knowledge and ‘state of the art’ policy shared among transnational policy communities; *harmonisation*, where policy converges through the adoption of basic shared international norms; and *penetration*, which occurs when policy convergence results from external actors and interests, where the state’s autonomy in policy making is curtailed and instead ‘the state is presumed to act in accordance with the preferences of the dominant social group rather than its own’ (pp. 220-226 & 232). These four descriptions of processes that lead to the adoption of a policy are not mutually exclusive. As this thesis shows, in the case of Indonesia’s HWI taxpayers unit, Bennet’s processes

resonate with different aspects of the implementation of the HWI unit. To understand the adoption and early history of the HWI unit in Indonesia, this thesis will traverse literature of policy convergence, diffusion and transfer (Chapter 1) and global regulation (Chapter 2).

Taxation is a subject that combines economic, political, social and cultural dimensions, and as such needs to be understood from both a globalisation and internationalisation perspective. With globalisation has come mobile capital and increasing numbers of HWIs whose business interests and assets cross national boundaries. Economic development in emerging economies (e.g., Brazil, China, India, Indonesia and South Korea) has contributed to the increasing population of HWIs, adding to the global number of HWIs from developed economies (e.g., Australia, Japan, the US and the UK) (Becerra et al. 2012; Capgemini & RBC Wealth Management 2013). HWIs are people who, based on their net worth, exceed a certain wealth threshold (definition of wealth and arbitrary thresholds vary across states), and thereby fall into this category.<sup>8</sup> The fast-growing population of HWIs internationally poses similar challenges to state-based tax authorities around the world in terms of managing their tax compliance. Challenges include: more complex business and tax affairs which generally include financial interests that transcend national boundaries; greater opportunity and greater access to resources to undertake tax minimisation practices through aggressive tax planning; greater amounts of tax revenue at stake than for individual taxpayers more generally;

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<sup>8</sup> Net worth is defined as current value of assets less current value of liabilities or debt. Some scholars (e.g., Slemrod 2002; Wolff 2002) distinguish high-wealth individuals from high-income individuals. The latter refers to people who fall into this category based on the amount of annual income they earn. The threshold of either net wealth or annual income used for categorisation of the high-wealth individual or high-income individual varies from one tax authority to another and from one institution (e.g., research institutions) to another.

and greater capacity through their non-compliance to undermine the integrity of the tax system (OECD 2009a, p. 3). Facing these similar challenges and threats to their revenue base, tax authorities have an incentive to learn from each other. A policy specifically designed to monitor tax compliance of HWIs that is regarded as a success in one country encourages tax authorities in other countries to learn from and adopt it. ‘Voluntary’ learning by policy officials, however, is only one explanation as to why a policy in one country is adopted by another.

All states have an eye to collecting their fair share of tax from HWIs operating across national boundaries, but how they do this depends on a range of factors, including legal, political, trade and cultural considerations. At the same time, international pressure can be significant. As Bernstein and Cashore (2000) noted, internationalisation of policies occurs when policies which traditionally operate within a domestic domain ‘face increased scrutiny, participation, or influence from transnational actors and international institutions, and the rules and norms they embody’ (p. 72). Consequently, states’ autonomy in developing policies that are feasible for their own context is reduced to the point where they may have no choice but to agree (voluntarily or coercively) to adopt global norms or practices.<sup>9</sup> Such norms and practices do not always fit in their local context. Pressures from the global environment (or actors) force individual countries to adopt certain principles and embed them in their policies (e.g., transparency may have to be embedded in environmental policy, occupational health and safety policy, privacy protection policy, or tax policy). When pressure of this kind is exerted on the world stage, convergence begins to occur, that is, policies tend to grow more alike, in the form

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<sup>9</sup> Bennet (1991, p. 215) presented a different view. He argued that policy convergence should not always refer to an absence of state autonomy, but rather processes of policy convergence may still occur through states’ autonomous preferences to formulate convergent policies.



of increasing similarities in structures, processes, and performances (Drezner 2001; 2005; Kerr 1983, p. 3).

Policy convergence in domestic tax laws among European Union (EU) members, with a pre-determined and agreed principles, is an example of how domestic tax policies have become more consistent (e.g., Kemmerling 2010; Ladi 2000). The principle of fiscal neutrality is evident in EU tax harmonisation, where EU members are ‘forced’ to adopt that principle in their domestic tax laws ‘to ensure fair competition throughout the single market’ (Mousis 2011, sec. 14.1.2). Less explicitly coercive are the global changes observed by Swank (2006). He traced the way in which nations have moved toward the adoption of neo-liberal tax reform. One factor has been the way in which ‘the capacity of mobile asset holders to move investment across national borders forces incumbent governments ... to compete for investment. Taxes on capital (and generally mobile, high-income earners) are progressively lowered...’ (p. 851). Swank is one of several researchers who have argued persuasively for understanding policy adoption in terms of a combination of factors, of which global competition is one.

My research concerned the adoption of a policy from other jurisdictions due to the influence of both extraneous and domestic factors. Using the adoption of an HWI unit in Indonesia’s DGT as a case study, I examined factors that facilitated or impeded the implementation of the HWI unit, an initiative that had previously been embraced by other countries including Australia, France, Hungary, Ireland, Japan, the Netherlands, New Zealand, South Africa, Spain, the U.S., and the UK (OECD 2009a; 2013b). The case study used a policy transfer framework, a concept that emerged in recent years as an attempt to unify some of the theoretical insights that varying disciplines have contributed. Within a policy transfer process officials may choose to adopt a new policy

wholesale or make changes to an existing one. In the area of taxation both kinds of changes occur. Indonesia's HWI initiative involved the adoption of a mode of administration of the tax system that went beyond adoption of a new policy. It changed public administration and challenged the values and assumptions built into public administration more generally.

The adoption of the HWI initiative in Indonesia was the result of a culmination of multiple forces from inside the DGT, from influential bodies and nation states, and from global factors. Internally, pressures to generate more tax revenue for the state budget on one hand, and to appear competent and professional in front of wealthy taxpayers on the other, forced DGT to look for a way of collecting tax (DGT 2009) from its wealthiest taxpayers that was cost-effective as well as respectful of investors or future investors. Various policy alternatives had been tried in the past, from reforming tax laws and administration to establishing large taxpayers units (LTUs) for corporate taxpayers in the early 2000s (Rizal 2006). Increased tax revenue remained a priority (Brondolo et al. 2008); there seemed little harm in DGT adopting a policy that was being used elsewhere, and hailed as a success for lifting tax collections without alienating taxpayers. Externally, forces for the adoption of a HWI unit were also at work. Policy recommendations appeared in an OECD report (OECD 2009a) for tax authorities to establish a dedicated unit within their structure to deal with HWIs. Such a recommendation encouraged Indonesia's tax authority to adopt the HWI initiative. More direct and operationally significant influence came from a 'policy intermediary' (Stone 2011, p. 491), the IMF, which provided assistance during the adoption process.

Transferring a policy from other jurisdictions has been advocated as a cheaper and more rapid option for policymakers to pursue than developing the policy from scratch (see for

instance Marsden & Stead 2011).<sup>10</sup> When policymakers face a problem that they believe is a common one (not unique to them), and they are aware of the availability of a solution elsewhere, then transferring policy from elsewhere to solve the problem is an attractive option (see for instance Rose 1993).<sup>11</sup> Developing policy from scratch is costly and time-consuming, and presents risks, particularly if policymakers are facing problems that need a quick solution and they fear that their credibility as public officials is under scrutiny. Time and resource constraints encourage policy-makers to find a policy that they understand is effective elsewhere, to learn from it, and to adopt and implement it in their context.

Advances in communication and information technologies facilitate lesson-drawing (Rose 1991) of this kind much more easily than in the past. Policy documentation from around the world can be accessed through the internet as a primary source of information in the policy transfer process. Yet, adopting a policy developed in a very different setting from its destination poses risks at the implementation stage. Economic, social, political and ideological differences between the originating and adopting country, if not well considered, will hinder the achievement of the underlying policy objectives (e.g., Hulme 2005; Jacobs & Barnett 2000). At worst, it might also cause the policy to depart in a different direction from what was intended originally. As Common (2001, p. 3) observed, '[u]ndue haste to seize on policies and programmes developed in other countries apparently shows little appreciation for the potential consequences of

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<sup>10</sup> 'Examples from elsewhere are often seen by politicians and civil servants as a quick, *cheap* and/or simple means to solve their problem without reinventing the wheel...' (Marsden & Stead 2011, p. 493, emphasis is added).

<sup>11</sup> This may involve direct copying or thoughtful adaptation, the basic point being that learning from others expedites the policy implementation process.

importation and transplantation'. Examining this problem in the case of HWI units was the primary focus of my research.

The purpose of this chapter is threefold. First, it provides a review of the vast literature on how a policy in one jurisdiction converges with one in another country. Under the umbrella of globalisation, I review the literature on policy convergence, policy diffusion, and policy transfer in order to get a better understanding of the similarity and the difference between the concepts. Second, this chapter highlights key empirical works pertaining broadly to policy convergence, diffusion and transfer, and specifically to policy transfer research that explored tax policy transfer. Lastly, based on theoretical frameworks discussed earlier, this chapter contains the hypotheses that guide this research.

## **1.1 Reviewing the literature on policy transfer**

The literature concerned with explaining why policies developed in one country are also adopted in another can be divided into three main categories, each with its distinct methodological approach and focus. The first is the policy convergence literature, discussed in the first part of this section. Policy convergence studies offer the phenomenon of globalisation as the fundamental explanation as to why national policies are becoming more alike. Globalisation means that as barriers to the transfer of goods, services and people are broken down (Stallings 2007), economic challenges observed in one country are also observed in others as they compete with each other for trade and investment. In other words, globalisation and the pressure for change that it creates are used by policy convergence theorists to demystify the phenomenon of policy convergence among countries. This literature is relevant to understanding the challenge that Indonesia faced in needing to find a way of taxing its HWI population, with their

capacity to transcend the legal obligations imposed by nation states. The taxation of HWIs was not a problem unique to Indonesia but rather was a problem shared with all other democracies because HWIs have mobile capital and assets that can span the globe.

The second relevant category of literature, discussed in the second part of this section, covers studies broadly identified as policy diffusion research. Policy diffusion is distinguished conceptually from policy convergence (discussed below in section 1.1.1) and policy transfer (discussed below in section 1.1.3). Policy convergence assumes that similarity in policy in one place has evolved independently of what has happened elsewhere. Unbeknown to each other, nation states will come to favour certain arrangements because the arrangements are conducive to dealing with pressures that have emerged with a global economy. In contrast, diffusion studies add a further layer to the analysis of global sharing of policy. Diffusion studies open the analysis to the assumption of active engagement by actors in the dissemination of policy and program ideas (Common 2001, p. 12). While policy convergence research looks for explanations for why everyone is doing the same thing independently of others, policy diffusion research seeks explanation for why certain states engage with particular policy options while other states follow different paths or remain untouched by international convergence. Diffusion studies examine a range of factors that could account for differences, including economic, structural, geographical, political and networking determinants.

The third body of literature revolves around the issue of policy transfer. In general, these studies provide a more in-depth analysis of cases and how and why transfer has occurred in a particular form. Policy transfer studies pay particular attention to the role that actors play in consciously choosing to adopt, or adapt, and implement a policy or

idea in another jurisdiction. According to Common (2001), for transfer to occur, ‘they [policies and ideas] must be adopted and implemented’ (p. 14). Common pointed out that a policy and idea may be diffused without being adopted. ‘Policy transfer becomes an observable process once organisations and actors pick up a policy idea or model’ (p. 14). The formation of the HWI unit within the DGT was a process of adopting and implementing an idea and program from other countries, with Australia in particular serving as a role model. The policy transfer framework, therefore, has immediate appeal for this study of adoption and implementation of the HWI unit. The reason for choosing a policy transfer framework is discussed further in section 1.2.

### **1.1.1 Globalisation and policy convergence**

Similar problems faced by policymakers in various jurisdictions resulting from globalisation force states to find solutions in the forms of similar policies, institutional designs, or administrative arrangements. These similarities may occur independently from one country to another due to policy-making processes that recognise similar characteristics of the problem. The globalised economy triggers similar analyses across countries, and the analyses, in turn, give rise to similar solutions that contribute to convergence. The theory of convergence, according to Wilensky (1974, p. xii), is the idea that whatever political economies, unique cultures and histories societies may have, over time they become more alike in both social structure and ideology.

This argument has relevance for the current research because, as the result of globalisation, tax authorities are confronted with relatively similar problems associated with the rise of capital flows. The globalised economy makes capital flow at a much greater pace than a few decades ago (Stallings 2007). Indonesia, despite its relatively high rate of economic growth, has been experiencing a high level of capital flight

(Harrigan, Mavrotas & Yusop 2002; Maski & Wahyudi 2012). According to Khan and Haque (1985), capital flight can reduce governments' ability to generate revenues and to service external public debt; with the erosion of the tax base, the need to borrow from abroad rises, thereby increasing the foreign debt burden. This phenomenon has become a critical challenge for Indonesia and other ASEAN countries (e.g., Malaysia, the Philippines and Thailand) (see also Basri & Hill 2011; Beja 2006).

The following example illustrates the phenomenon that contributes to convergence in tax policy. Increasingly free capital movements between jurisdictions, coupled with opportunities for firms to disperse geographically, create problems between countries in terms of determining taxing rights. Owen (1993, p. 23) has argued that as the base for taxes on income and wealth becomes geographically mobile, taxpayers become more sensitive to tax differentials. The problem arises due to different national taxation norms and interstices between jurisdictions (FitzGerald 2002). These conflicts appear in the form of international double taxation when two or more jurisdictions exercise conflicting principles in determining their tax base. The 'income source principle' grants to the country from which income is generated the right to tax the income. The 'residence principle', on the other hand, gives taxing rights to the country in which people or firms reside, regardless of the source of their income (Devereux 2008).

If not resolved, conflicts of these kinds create uncertainty for business. Countries that entertain uncertainty will deter investment and lose in competition with other countries to attract or retain business. Not only will this result in declining investment, but also the loss of tax revenue. In order to minimise these effects, international institutional frameworks for international tax cooperation have developed. These frameworks (e.g., the OECD's model tax convention on income and on capital and the United Nation's

model for a double taxation convention between developed and developing countries) remove conflicting interests that strain economic relations between countries. Moreover, they provide taxpayers with certainty by clarifying and standardising taxpayers' fiscal situations when they engage in activities in different jurisdictions (OECD 2010). These international regulatory frameworks contribute to convergence in how countries define income for taxation purposes to avoid double taxation. The trigger for such convergence does not lie with particular states and their governments, but rather with globalisation and capital flows.

A country's choice to adopt and implement policy to address problems created by capital flows is no longer independent of the global setting. The adoption of the HWI initiative in tax administration is another example of how a policy choice is influenced by the global environment. Global growth in the number of wealthy individuals requires tax authorities around the world to anticipate this phenomenon; otherwise, they will lose opportunities to generate tax. Resource-rich HWIs have greater access to practices that make it possible to minimise their tax obligations through using certain business structures such as trusts, or moving their capital from one place to another easily as the result of the globalised economy. Furthermore, determining and collecting taxes on activities that take place outside a country's tax jurisdiction becomes more difficult (Owens 1993, p. 23), particularly as the mechanisms for tax avoidance become more sophisticated (e.g., using transfer pricing arrangements with intellectual property).

The following illustration adopted from Sheppard (2010) explains how intellectual property (IP) can be used as a way to minimise tax. Suppose a US multinational company wants to sell high-margin Chinese-made products to German customers. The company puts its IP in a tax haven, and requires its Chinese manufacturing affiliate to



pay royalties. The company also converts its German distributor to a stripped-risk intermediary called a commissionaire to limit taxable profits of the affiliated distributor in Germany. Those profits are booked to a principal company in a European tax haven as compensation for assuming inventory risk. Consequently, no profits are taxed in the United States, and little in Germany. Anticipation of these problems can be in the form of cooperative action between tax authorities, though the lag between recognition of the problem and action tends to be measured in decades rather than years (e.g., Avi-Yonah 2000 for tax competition; Rawlings 2007 for transnational tax treaties with regard to tax havens).

As problems arising from globalisation are shared and countries realise they can learn from each other's experiences, the third phase of globalisation (Deprez 2003) emerges, in which international coordination, harmonisation, and standardisation become important elements in inter-state relations.<sup>12</sup> This phase of globalisation occurs when 'order and organization are imposed...' (p. 372). International policy coordination, harmonisation, and standardisation provide a partial explanation as to why international experiences and policy structures influence national policy choices (Stone 2002, p. 2).

A question remains: How does convergence occur? Daniel Drezner (2001, pp. 56–64), after reviewing theories that relate the concept of globalisation to policy convergence, proposed a simple 2x2 schema to capture differences between various theoretical accounts. According to Drezner, the first dimension on which theories vary is whether

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<sup>12</sup> According to Deprez (2003, pp. 371–372) the globalisation process can be identified into three distinct phases. The first phase is dominated by the breaking down of traditional trade barriers. The first phase of globalisation is aimed at reducing and eliminating both tariffs and non-tariff barriers. The second phase of globalisation involves restructuration of the domestic component of a country's economy that alters the way in which the economy operates. Key components of this phase are deregulation and privatisation.

the prime emphasis is on structural forces or whether there is also recognition of the power of autonomous agents. The former defines the structural approach in which most attention is given to the role of extraneous factors that affect political units. Environmental conditions determine states' courses of action by strictly limiting the possible national responses to a certain problem. In contrast is the agent-centred approach which, while still acknowledging the role of extraneous powers that constrain national policy responses, also acknowledges that within these bounds, states have power to choose among the policy alternatives available.

The difference between those schools of thought, Drezner (2001) maintained, is in the language they use to describe international regulatory regimes. Structural approaches view convergence as the dependent variable: Different national policies are homogenised into one global policy due to transnational power that constrains political units. Agent-based approaches use the term policy coordination and look for coordination to illustrate policy convergence. Policy coordination reflects states' agreement on acceptable policy principles. In reality, states may differ in developing their rules or regulations, but the principles upon which the rules and regulations are developed are similar. The abovementioned example of fiscal harmonisation in the EU illustrates well how policy coordination occurs when certain 'acceptable bounds of regulatory policies' are agreed to by states (Drezner 2001, p. 57), while still providing them with sufficient spaces to manoeuvre in response to their domestic constituency (e.g., in determining tariffs on VAT under a predetermined standard VAT rate) (see also Eccleston 2006). However, in some cases (e.g., taxes on capital and labour), the room to manoeuvre is relatively limited (Swank & Steinmo 2002, p. 651) due to intensifying pressures faced by contemporary democratic polities.

The second dimension of Drezner's 2x2 schema relates to the source of the pressures for convergence. One approach views economic factors as the principal source of pressure for convergence. According to Drezner (2001), the threat of the flight of mobile capital has pushed states to modify their regulatory policies. This implies states that do not follow suit will lose their competitiveness in the global economy. The other approach on the source of pressure to converge is ideational. According to Drezner (2001), 'states alter institutions and regulations because a set of beliefs has developed sufficient normative power that leaders fear looking like laggards if they do not adopt similar policies' (p. 57).

Drezner's schema offers useful insights into the approach that is most suitable for understanding the adoption and implementation of the HWI unit in Indonesia. If external economic factors were the main source of influence for policy convergence, the story of the HWI unit in Indonesia may have been somewhat different. For example, the theory of a 'race to the bottom' predicts that mobility of trade and capital flows contribute to policy convergence by forcing the state to act in accordance with market forces. According to this theory, capital will seek places that provide the highest rates of return, and states will compete to attract capital by lowering their regulatory standards (Drezner 2001, p. 58) (e.g., using low tax rates, flexible tax compliance monitoring, or lenient environmental regulations) (see also Swank & Steinmo 2002 for tax rates on capital and labour). This structural model leads to an expectation for policies to converge 'at the bottom'; however, convergence in tax collection strategies (as opposed to tax rates) tends to be in the opposite direction. Tax authorities are becoming more stringent in monitoring tax compliance of very wealthy taxpayers by adopting relatively similar approaches and setting in place institutional arrangements that are more 'at the

top' than at the bottom. Understanding the development of the HWI unit in Indonesia requires recognition of factors beyond the economic, although there can be no argument that global economic changes create a challenge for tax collectors in relation to HWIs regardless of where they operate or reside.

An approach to policy convergence theory that extends beyond a standard structural economic approach was offered by Meyer et al. (1997): the world society model. The model suggests that '... society would rapidly adopt 'modern' structures and purposes upon incorporation into world society' (p. 148)<sup>13</sup>. Policy convergence according to this model is driven more by the need for nation-states to conform to a world-wide model, irrespective of the applicability of the model to their local context. More often than not, copying world models takes the form of simple mimesis (DiMaggio & Powell 1983) that gives more attention to nominal rather than substantive problems (Drezner 2001).<sup>14</sup>

Meyer et al. (1997) provided an interesting example of how, in the 1950s, many countries re-structured their mass schooling systems around a six-year/three-year/three-year model in order to meet the United Nations Educational, Scientific and Cultural Organization (UNESCO)'s requirement of comparable educational enrolment data. The reason was simply that UNESCO's statisticians chose to report enrolments for the six-year primary level and three-year junior level and three-year senior secondary level.

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<sup>13</sup> Although a world society model 'de-emphasizes conventional notions of social actors and agency' (Hironaka 2014, p.4), the model does not negate the role of actors as Drezner puts it: 'These approaches [the race-to-the-bottom hypothesis, the neoliberal approach, and the world society theory] posit a world where an ideational structure dominates individual agency. This statement implies that a world society model can still provide space for the role of agency; it is just that agency is not independent of broader global forces.'

<sup>14</sup> Mimesis refers to a 'rhetorical term for the imitation, re-enactment, or re-creation of someone else's words, manner of speaking, and/or delivery' (Nordquist 2014). In policy context, it refers to the imitation of a policy from another jurisdiction with more attention given to the "surface value" of the policy than to its substance.

Copying of this model generally occurred ‘without investigating whether it would best meet any of the presumed purposes of schooling’ (pp. 158-159). Meyer and his co-authors cited support for their approach from how ministries and agencies are named internationally. Common evolving world-societal models lead states to establish quite similar ministries and agencies, because they need to conform to ‘an ideal of the rationalised bureaucratic state’ (Drezner 2001, p. 61). This situation contributes to a ‘institutional isomorphism’, in which agencies become more alike in their structure, process, and behaviour (DiMaggio & Powell 1983).

One of the processes that shapes such isomorphism is the construction of nation-state identity and purpose (Meyer et al. 1997, p. 157). Meyer and his colleagues argued that the increasing number of countries that adopt other prescribed institutions of modernity is due to their orientating themselves to the identity and purposes of the nation-state model. As national leaders are committed to the identity of the rationalizing state, some policies that reflect that identity are adopted (p. 159): policies for social welfare, the education system, taxation and development economics. Moreover, even if a state does not fully agree with the world identity model, it will still try to pursue many purposes within this model by developing modern institutions such as a central bank or modern tax administration.

In summary, the globalisation perspective may in part provide an explanation for policy convergence between Indonesia and more developed countries. HWIs with mobile capital and international residences challenge tax authorities everywhere. But more than an economic explanation is required for why Indonesia became one of the relatively small group of countries in the world to adopt a HWI unit, particularly given that most in the group are developed countries. The world society model (Meyer et al. 1997)

connects globalisation to policy convergence by arguing that nation-states have a need to conform to an ideal of the rationalised bureaucratic state. In her study on Indonesia's adoption of a new bankruptcy law in 1998, imposed by the IMF following the country's economic crisis (an IMF loan was conditional on adoption of the law, among others), Steele (1999) found that the adoption of the new bankruptcy law was used by the IMF as 'an index of modernity' of Indonesia's legal infrastructure (p. 147). Modern, in this context, according to Steele, refers to reforming and changing law to encourage and support a market economy by accommodating the perceived needs of investors and business people (pp. 144-145). In the context of Indonesia's tax administration, administrative reforms conducted in 2002 and 2008 through organisational restructuring were undertaken to achieve what was called a 'modern tax administration' (Pandiangan 2008; Rizal 2006; Rizal 2011).

The world society model describes the adoption of policies or institutions that depict modernity. Nation-states, despite differences in economic development, political structure, or cultural tradition, are eager to converge with other modern states by adopting a standardised form of policies and institutions. This increases rates of institutional isomorphism (DiMaggio & Powell 1983). This model, nevertheless, does not take sufficient account of the role of state actors in the spreading of particular policies from one country to another. Diffusion studies are discussed in the next section to uncover what they can contribute towards an understanding of why Indonesia adopted a HWI unit and other similar countries have not. While diffusion studies maintain a strong emphasis on structural explanations, they also give attention to the aspect of agency.

### **1.1.2 Policy diffusion**

Unlike the policy convergence literature that gives most attention to policy and institutional similarities across nation-states (Bennett 1991; DiMaggio & Powell 1983; Kerr 1983), policy diffusion studies focus more on the processes that result in policy similarities (Knill 2005, p.3) – the drivers of policy diffusion. Rogers (2003) defined diffusion as ‘the process by which an innovation is communicated through certain channels over time among the members of a social system’ (p. 5). Diffusion is also described as ‘the chronological and geographic patterns of the adoption of a policy innovation across government units (Squires & Lord 2012, p. 819). These definitions depict the interdependence of the process: Actors communicate innovation. In other words, many stakeholders and networks are involved in a policy innovation process (Leeuwis & Aarts 2011, p. 23) and they communicate with each other to disseminate the policy.

However, criticism has been directed at suggestions that the policy diffusion process is limited to direct contact between prior adopters and potential adopters (Strang 1991). In response, Strang offered a more general definition of diffusion that encompasses indirect contact between actors. Strang (1991) used the term diffusion to refer to ‘any process where prior adoption of a trait or practice in a population alters the probability of adoption for remaining non-adopters’ (p. 325). This leads to the incorporation of the idea of ‘uncoordinated interdependence’. That is, diffusion may occur through watching what others are doing. An innovation might be tested out in one country, emulated by some and rejected by others (Elkins & Simmons 2005, p. 38). Elkins and Simons identified the lack of coordination in observed interdependence as the essential feature or important quality of diffusion in comparison to other means of policy dispersion: ‘the

action and choices of one country affect another, but not through any collaboration, imposition, or otherwise programmed effort on the part of any of the actors' (Elkins & Simmons 2005, p. 38).

Having identified the focus of the diffusion literature as 'pattern finding' (Marsh & Sharman 2009, pp. 275–276) across jurisdictions, it is not surprising that the dominant methodology in diffusion studies uses quantitative techniques to analyse large N cases and draw conclusions that are expressed as generalizable statements about causes and consequences of diffusion. Several of diffusion studies have been undertaken in the taxation domain.<sup>15</sup> Studies by Ashworth, Geys and Heyndels (2006), Martin (2010) and Miller and Richard (2010) are briefly described below.

Ashworth, Geys and Heyndels (2006) examined the factors that determine tax innovation. In doing so, they explored the introduction of new environmental taxes (or 'green taxes') across 308 Flemish municipalities in Belgium over the period 1991-1999. The study predicted the probability of a given municipality adopting the green tax from internal and regional factors. The internal determinants were 'factors within the jurisdiction that affect innovative behaviour' (p. 232), and included: per capita revenue from all other kinds of taxes; the amount of waste per capita; election year; government ideological position; the number of parties participating in government (single-party government or coalition government), and fragmentation within government. External factors aiding diffusion referred to influences from other jurisdictions that encouraged a given jurisdiction to adopt a similar green tax policy. External variables included the

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<sup>15</sup> See Appendix A for a more detailed account of the method used for literature search on policy diffusion and transfer studies in the taxation area and Appendix B for the summaries of the studies.



percentage of neighbouring municipalities with a green tax and the percentage of second-order neighbours (neighbours of neighbours) with a green tax.

Ashworth, Geys and Heyndels (2006) concluded that the diffusion of the green tax among Flemish municipalities followed a pattern dictated by the electoral constraints under which incumbent governments work. Importantly, the study underlined the role that political factors played in the adoption of environmental tax policy. At the same time, Ashworth and his colleagues found that a green tax was more likely to be adopted when neighbours had already adopted such a tax. The relationship was strongest with direct neighbours, but also evident for second-order neighbours. In addition to spatial proximity, ideological proximity increased the likelihood of adopting a green tax.

A study conducted by Christian Martin in the US also typifies the diffusion studies tradition. Martin (2010) drew 1728 observations from the 48 contiguous US states in order to predict the level of cigarette taxes in a particular state. Martin examined the average tax levels in adjacent states for their diffusion influence, along with domestic factors, the most important of which was the government's ideological position. Martin hypothesised and found that diffusion from one state to another was conditional on ideology: 'The ideological position of the government changes the diffusion influence' (p. 7). Left-leaning governments will adopt the higher tax rates of their neighbours following a diffusion model, but right-leaning governments will not. Right-leaning governments often respond competitively and lowered their tax rates. The study concluded that interdependence studied through diffusion research needed to aspire to a further level of sophistication. Martin proposed addressing 'conditional diffusion' (p. 20) so that interdependence and domestic conditions in a globalised environment could be analysed side by side, along with their mutual influence.

Like Martin (2010), Miller and Richard (2010) employed a large N and mathematical modelling (event history analysis) (Newmark 2002). They examined 772 state-year observations of policy diffusion of state research and development (R&D) investment tax credit among US states. What distinguishes Miller and Richard's study from Ashworth, Geys and Heyndels' (2006) and Martin's (2010) studies discussed above is that they also employed qualitative interviews to enrich their quantitative analysis. Miller and Richard hypothesised that adoption of R&D tax credits was more likely in states with: higher unemployment rates; lower per capita incomes; higher patent activity; greater federal R&D spending; a more prominent manufacturing sector; a single party with legislative control; and a higher percentage of economically similar states and of contiguous neighbouring states having previously adopted the policy (pp. 27-28).

Miller and Richard (2010) concluded that the adoption of R&D tax credit policy is strongly related to an existing manufacturing base and that political factors aided the implementation of that policy. They suggested that not only is the manufacturing sector more R&D intensive, but a larger manufacturing sector will have increased political power that allows sectoral interests to push through legislation from which they will gain benefits (p. 30). Their study also found that economic proximity rather than geographical proximity between states led toward adoption of the policy.

Through investigating the role of factors such as geographical proximity (Ashworth, Geys & Heyndels 2006), ideological closeness (Martin 2010), or economic proximity (Miller & Richard 2010), diffusion studies have looked for explanatory variables beyond structural factors. These studies highlight the importance of not just looking at pressures beyond the state, but also within the state. Domestic, national, and

international factors matter. Beyond this observation, however, diffusion studies can be criticised for not offering a nuanced understanding of the adoption of similar policies by different countries or states (Marsh & Sharman 2009, p. 270).

The implicit assumption is that the same policy framework can be adopted in various national settings (Common 2001, p. 12). As Weyland (2005) pointed out: ‘these waves of diffusion affect countries that are at very different levels of economic, social, and political development’ (p. 262). The major concern of diffusion studies has been more about the width of the dispersion of policies and less about the depth of the diffused policy in its influence on particular countries. All states are assumed to adopt exactly the same policy and there are no variations in the policy adopted by those states (Clark 1985, p. 63).

In reality, although policies seem the same superficially, there is almost always variation in the extent to which a policy has been adopted, as with the HWI case in this thesis. This variation relates to the policy environment in which the policy is introduced. A ‘forest–trees’ analogy is useful for identifying the essence of diffusion studies. A diffusion study sees the forest from a very long distance. The trees look much the same, but when one leaves the diffusion study framework and examines the forest close up, the trees become much more diverse and are less likely to be easily identified with the whole.

Moreover, few diffusion studies have explored the role of agency. This is mainly because the quantitative large N methodology applied in many of the diffusion studies does not lend itself to providing an analysis of the role of agents, or to a more nuanced analysis of diffusion generally (Marsh & Sharman 2009, p. 274). In particular, Marsh

and Sharman argued that the quantitative methodology used by diffusion scholars makes it difficult to take account of the meanings that agents, whether bureaucrats or elected actors, attach to structural factors. This, however, is not to suggest that diffusion scholars deny the role of agents in the process of policy diffusion. As Newmark (2002) pointed out: ‘It may not be the case that agents have a lesser role in policy diffusion, rather less attention may be paid to their role in the process [of diffusion]’ (p. 170). The utilisation of qualitative interviews in Miller and Richard’s (2010) study may answer this criticism. A more complete literature review on diffusion and policy transfer studies in the area of taxation is presented in section 1.2.

In summary, the diffusion literature provides insights into the kinds of factors that lead to the adoption of similar policies by some countries or states. Using quantitative techniques and mathematical modelling, diffusion research is able to predict to some degree who the adopters of a particular policy will be, based on information about the structural features of the countries and a host of economic, political and geographical variables. In diffusion research, ‘any pattern of successive adoption of policy innovation’ (Eyestone 1977, p. 441) is called diffusion, without consideration of whether or not actors were aware of the existence of similar policy models elsewhere, or were interested in utilising the model to formulate policy in their own context.

Identification of a pattern of successive policy adoption falls short in providing sufficient explanation of how or why a policy has been adopted (Bennett 1991). As Bennett pointed out: ‘...the policy diffusion literature focuses more on the spatial, structural and socio-economic reasons for a particular *pattern* of adoption...’ (p. 221, italics in original). A deeper understanding of why and how policies are transferred is the aim of the third body of research on policy adoption: the policy transfer literature.

Policy transfer researchers focus on the role of agents, their motives and their aspirations, in the transfer of policy. Table 1.1 contrasts the research elements of the diffusion and policy transfer literature; the latter is discussed further in the section below.

**Table 1.1 Comparisons: Policy Transfer and Diffusion**

	<b>Policy transfer</b>	<b>Diffusion</b>
Cases	Few cases	Many cases
Methodology	Qualitative	Quantitative
Generalizability	Low degree	High degree
Statistical modelling	Little or none	Complex/mathematical
Prediction	None	High degree

Source: Adapted from Newmark (2002, p. 160)

### **1.1.3 Policy transfer**

It has been recognised that policy in one jurisdiction may draw inspiration from others, but there has been debate about how to refer to the process (Jacobs & Barnett 2000, p.187). Terminology includes ‘lesson drawing’ (Rose 1991), diffusion (Majone 1991), emulation (Hoberg 1991), policy transfer (Wolman 1992), and ‘social learning’ (Hall 1993). The concept used for the purposes of my research was policy transfer. Building on work by Dolowitz and Marsh (2000), policy transfer is defined as a ‘process in which knowledge about policies, administrative arrangements, institutions and ideas in one political setting (past or present) is used in the development of policies, administrative arrangements, institutions and ideas in another political setting’ (p. 5). The key characteristic that differentiates policy transfer from policy diffusion is the

element of consciousness in adopting a policy from another jurisdiction. Both policy convergence and diffusion are attributed to structural dynamics in an international environment that give rise to similarities in problem-solving and policy responses. Policy transfer research has an additional prerequisite: Policymakers must have awareness of, and demonstrate interest in, the policy and institution of the other system (Dolowitz 1997, p. 24). Therefore, Wolman (2009) asserts that ‘policy transfer ... requires “policy learning”’ (p. 1).

In order to analyse the process of policy transfer, a framework needs to be developed which identifies elements in the process. Dolowitz and Marsh (2000) suggested that such a conceptual framework will help to better understand motivations that drive policy-makers to engage in the policy transfer process, how and when policy transfer occurs in the policy-making cycle, and who is involved in the process. These issues are addressed through the Dolowitz and Marsh Model (Dolowitz & Marsh 2000). The framework revolves around eight questions<sup>16</sup>: Why has the transfer occurred and with how much coercion? Who is involved in the transfer? What is transferred? Where is the transfer from? What is the degree of the transfer (from copying to inspiration)?<sup>17</sup> What are the constraints on the transfer? How is policy transfer demonstrated by the adopter? And, what leads to failure when transferring policy? (See Table 1.2) This framework for

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<sup>16</sup> Five of which originated in their earlier work (Dolowitz & Marsh 1996).

<sup>17</sup> Rose (1993) establishes a typology of lesson-drawing (policy transfer) process which illustrates the degree of reflectivity that actors put into the process of transfer, namely: copying, adaptation, hybridisation, synthesis, and inspiration (pp. 30-32). According to Rose, copying merely involves enacting more or less intact a policy that was already in effect elsewhere. In adaptation, a policy that was adopted from another jurisdiction is adjusted to meet contextual differences. Elements of programs or policies from two or more different jurisdictions were combined to produce a hybrid policy. In synthesis, policies’ elements from different programs or policies are combined to create a new program. Finally, examination of policies from another jurisdiction serves as a source of inspiration instead of analysis of the policies; it is used only as an intellectual stimulus to develop a novel program.

analysing policy transfer is discussed below in relation to studies of policy transfer in taxation.

Before doing so, it should be acknowledged that the framework is a heuristic device that helps to systematically collect data that can be used for theory building. The framework is used in Chapter 5 to describe the background to DGT setting up the HWI unit in Indonesia. Evans and Davies (1999) have criticised policy transfer analysis because it is not based on an explanatory theory, since it does not provide ‘a systematically related set of statements, including some law-like generalizations, that is empirically testable’ (Rudner 1966, p. 10) as a theory commonly does.

Dolowitz (2000a, p.11) defended the concept of policy transfer and refers to its theoretical potential. The concept of policy transfer can serve as an independent variable. Policy transfer provides an explanation for why a policy change/innovation has occurred and a basis for explaining the policy outcome. For instance, failure of a policy to produce desired outcomes may be due to the policy being transferred from a dissimilar country, to it being coerced, the transfer being incomplete, or the civil servants being disengaged from the policy transfer process. On the other hand, policy transfer can be used as a dependent variable, whereby researchers explain under what circumstances transfer is more likely to occur (see for instance Evans 2004b, p. 11; Marsh & Sharman 2009, p. 278). For example, transfer might only occur after all stakeholders are consulted or when it is compatible with earlier policies and structures. Figure 1.1 illustrates the argument.

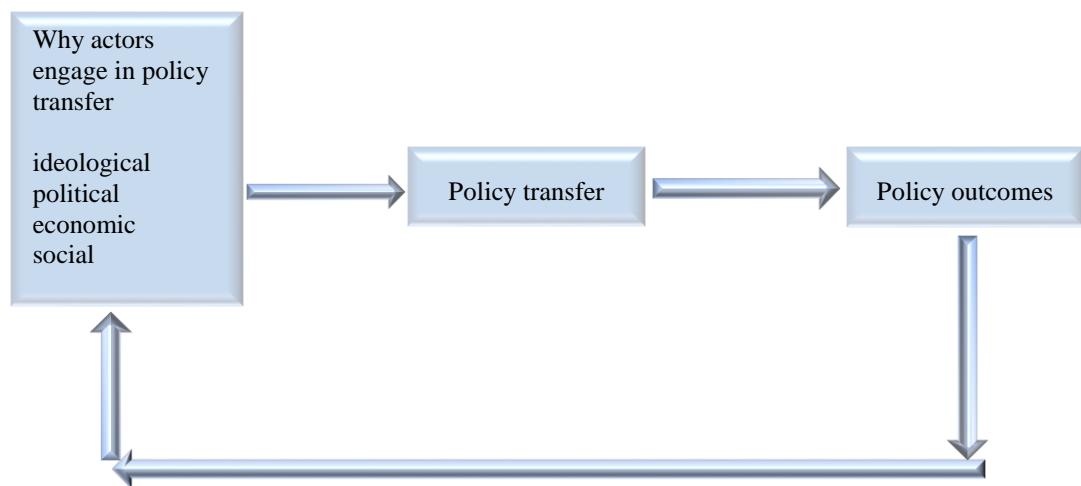




For the purposes of my research, the primary interest is in explaining the success or otherwise of the HWI unit in Indonesia and the form that the HWI unit took. Rose (2002, pp. 8–9) identified five conditions that need to be met when policymakers decide to transfer a policy from a particular country if the learning, and consequently the transfer, is to be successful: ideological compatibility; similarities in resources; psychological (not geographical) proximity; availability of evidence; and interdependence.

Dependent variable

Independent variable



**Figure 1.1 Policy transfer uncoupled**

Source: adapted from Dolowitz (2000, p. 11)

*Ideological compatibility*

It has been suggested that ideological proximity between originating and adopting countries explains why an adopting country chooses that country from which to transfer a policy (e.g., Legrand 2012a; Page 2000; Strang & Meyer 1993). Although there are no two countries in the world exactly the same ideologically, ‘perception of similarity’ (Strang & Meyer 1993, p.491) assists in policy transfer. Legrand (2012b), in his study

of the Windsor Conference Policy Network (WCPN) – an informal network of Anglosphere<sup>18</sup> public service mandarins from Britain, Ireland, Canada, Australia, New Zealand and the US observed a pattern of policy learning that could be attributed to ‘an underlying governance affinity that reaches back to the common history shared by Anglosphere countries’ and common institutions that facilitate active exchange of policy ideas and experiences among members (p. 537).

In the area of taxation, for instance, the Commonwealth Association of Tax Administrators (CATA) comprises 49 tax authorities from Commonwealth countries. Its primary mission is ‘to promote the improvement of tax administration’ through ‘the exchange of ideas and experiences’ among members (CATA n.d.). In Asia and the Pacific, the Study Group on Asian Tax Administration and Research (SGATAR) has a similar mission; this is not to say member countries have similar ideologies, but shared membership may lead some to consider themselves similar enough to engage in policy transfer.

Studies by Baturo and Gray (2009) and Ellis (2009) on the adoption of a flat tax in Eastern European countries confirmed the role that ideological factors played in the diffusion of flat tax policy. Although the flat tax promised countries a solution to the pressing issues of preventing tax evasion, attracting foreign direct investment, and simplifying tax collection, the adoption of the policy was only possible within governments with a certain political ideology, that is, centre-right governments.

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<sup>18</sup> Legrand (2012b) uses the term Anglosphere to describe a group of English-speaking countries ‘marked by differing degrees of sharing of the core Anglosphere characteristics’ or ‘a network civilisation without a corresponding political form’ (Bennet 2007, p. 80, cited in Legrand 2012b, p. 527).

### *Similarities in resources*

When adopting countries are attracted to a policy that has proven effective elsewhere, they sometimes overlook the extent to which resources were allocated by the originating country to make the policy work effectively. Resources include money, personnel, and institutional capacity (Rose 2002, p. 8). Too little of these resources commonly creates problems when developing countries try to adopt policies from developed economies. This often occurs when policy transfer is facilitated by a policy intermediary (Stone 2011, p. 491) such as the IMF, the World Bank or other international agencies and policy consultants that are not familiar with the adopting country's needs and resources.

...they [policy consultants] tend to offer advice based upon what they regard as the best practice elsewhere, often paying little attention to the particular context in the borrowing political system. (Dolowitz & Marsh 2000, p. 10)

International aid agencies and intergovernmental bodies such as the World Bank and the International Monetary Fund may recommend first-world programmes as best practice measures that developing countries ought to adopt. (Rose 2002, p. 8)

The establishment of the Large Taxpayers Unit (LTU) in the Indonesian tax administration in 2002 is an example of a first-world program adopted by a developing country as part of loan conditionality (Brondolo et al. 2008). The adoption of the HWI initiative, on the other hand, was influenced by the OECD's recommendation for tax authorities to establish a dedicated unit for HWIs within their organisations (OECD 2009a) based on similar practices that had been employed by its member countries. Examples provided in the recommendation, however, came from developed countries with better-resourced tax administrations.

### *Psychological, not geographical proximity*

Psychological proximity refers to the sense of comfort that actors experience while interacting with others who can offer policy lessons. As Rose (2002) suggested: ‘... policymakers should look for lessons in countries where they and their colleagues feel comfortable’ (p. 8). Elsewhere Rose gives an example of how Britain’s policy-makers are ‘ignoring geographical propinquity in favour of social psychological proximity’ by looking ‘across the ocean to the United States or Canada, or even farther away to Australia’ (Rose 1993, p. 107). If actors feel comfortable with those with whom they interact, learning a policy will be a much easier undertaking.

In discussing the adoption of a flat tax in Slovakia, Ellis (2009) described how the Slovak Prime Minister consulted with Estonia’s on how to make the transition from a former Soviet republic to a free market democracy and what kind of tax system was best suited to the transition. Ellis’ analysis addresses a range of issues relating to policy transfer, but included in the narrative are accounts of influential voices, reflecting the way in which psychological compatibility and significant others influence policy formulation.

Similarly, Gilardi and Wasserfallen (2009) noted how finance ministers from regional networks of Swiss cantons cooperated more than might have been expected if a competitive economic model was in play all the time. The finance ministers used their institutional networks to exchange information and coordinate collective action.

### *Availability of evidence*

Evidence about the policy in question is a valuable source of information for policy-makers in the adopting country. This may include other countries' legislation; policy recommendations and reviews provided by third parties; government documentation on the policy in question; and policy evaluations. Gathering such documentation is the first step for actors in the adopting country to learn about the policy. Evidence that actors gather informs them about the background of the policy initiative, from which they can learn how similar the policy problems of the originating country are to the adopter's problems; how the policy works in the originating country; and what regulatory and institutional arrangements were put in place to facilitate the operation of the initiative.

Without sufficient evidence, actors involved in the policy transfer will face challenges to convince stakeholders about the likely gain in implementing the transferred policy. Advances in information technology make the gathering of policy-relevant information much easier and facilitate comparison between policies in a more efficient way.

### *Interdependence*

In the taxation context, Jeffry Owens has asserted that 'greater interdependency [as the result of globalisation] will have profound implications for tax systems', especially changes in the ways in which tax administrations operate (Owens 1993, p. 23). Interdependence in policy, according to Rose (2002, p. 9), is an invisible force that pushes policy-makers to pay attention to what their counterparts in other countries are doing. The concept of interdependence recognises that policy does not work in a

vacuum. It is influenced by the global environment, but at the same time, policy choices influence the choices of others.

The policy transfer literature has immediate appeal in the tax context. Increasingly, tax authorities are becoming interdependent as capital becomes more mobile and individual states become less successful in collecting taxes from trans-national or multi-national corporations (TNCs or MNCs) and HWIs. Tax authorities are in contact with each other over a range of matters; looking to each other for new methods for collecting tax, and transferring these policies across jurisdictions is an attractive option. In the following section I review selected empirical literature on policy transfer (and diffusion) in taxation with respect to a subset of questions from the Dolowitz and Marsh policy transfer framework: where is the transfer from, who is involved, and why has it occurred?

## **1.2 Policy transfer in taxation: a literature review**

This section reviews selected studies that have contributed to an understanding of policy transfer in the taxation field. Articles were chosen based upon search terms derived from the principal elements of policy transfer (more detail accounts of criteria for selecting articles is provided in Appendix A). A summary of 24 studies, including the three discussed above in the context of policy diffusion, is provided in Appendix B. This section starts with reviewing the paradigms and methods employed by selected studies.

### **1.2.1 Research paradigms and methods**

The 24 studies reviewed here illustrate both diffusion and policy transfer approaches and methodologies at work. Ashworth, Geys and Heyndels (2006) tested a series of

hypotheses that reflected both previous findings on how domestic politics affect the adoption of new taxes and how regional diffusion should work across municipalities. Regional diffusion is represented by both spatial and ideological proximity. In contrast, Eccleston (2006) Radaelli (2000) and Sharman (2010), undertook more detailed analyses of how transfer takes place – how is it done, by whom and why, as well as the more problematic question of what exactly is being transferred? Radaelli (2000) has argued that the new challenge is to push the ‘processual perspective’ further instead of being satisfied with ‘mechanical transfer models’ (p. 39) and to begin paying attention to the logic of appropriateness in transfer studies as opposed to the logic of choice. The findings of the selected studies support the importance to the transfer process of perceptions of benefits, persuasion through networks, building credibility as a source of valuable information, technical legitimacy, strategically supporting initiatives that have been used ‘successfully’ elsewhere, and political alliances. Together these studies suggest that the policy transfer research field has moved beyond prime consideration of what is rational and efficient to a paradigm that incorporates bounded rationality and social influence.

The expansion in research approaches and methods that is evident in the policy transfer tax literature reflects movement toward what Marsh and Sharman (2009) called the ‘process-tracing approach’ of policy transfer analysis as opposed to the ‘pattern-finding

approach' of policy diffusion analysis (p. 269).<sup>19</sup> How policy transfer happens, what is transferred, by whom, why, and with what effects are the questions posed by Dolowitz and Marsh (1996; 2000) that are being addressed by this new wave of research.

The reviewed studies collectively raise important issues that guided my research. First, it is evident that most of the policy transfer in the tax field that has been studied through this framework involves developed countries, such as countries within the EU (Kemmerling 2010; Radaelli 2000; 2003) or OECD (Barthel & Neumayer 2012; Jensen & Lindstädt 2012; Cao 2010; Swank 2006; van Stolk & Wegrich 2008; Ward & Cao 2012) or between two developed countries (Christensen 2013; Squires & Lord 2012).<sup>20</sup> Other studies have been conducted at the sub-government level – states/counties within the US (Berry & Berry 1992; Kim, Bae & Eger 2009; Martin 2010; Miller & Richard 2010; Prakash & Caro 2010; Seljan & Weller 2011), cantons within Switzerland (Gilardi & Wasserfallen 2009) and municipalities within regional government in Belgium (Ashworth, Geys & Heyndels 2006).

Exceptions to studying policy transfer in developed sites include studies by Baturo and Gray (2009), Eccleston (2006), Ellis (2009), Sharman (2010), and Stewart (2007). Baturo and Gray's (2009) and Ellis' (2009) studies involved transitional countries in Eastern Europe, particularly post-communist countries. Eccleston included developing

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<sup>19</sup> See also Lee and Strang (2006) for the distinction between process-tracing and pattern-finding strategies in the diffusion literature. According to Lee and Strang, process-tracing research follows the spread of a policy or practice from one place to another. This strategy allows examination of the role played by external models, and inquiry into why and how a concrete example of learning or mimicry occurs. On the other hand, pattern-finding research tests a priori hypotheses about diffusion channels. Rather than demonstrate that actors in country A were aware of and influenced by country B, this strategy asks whether structures of covariance and temporal ordering are generally consistent with a theoretically specified model of influence.

<sup>20</sup> See for instance Evans (2004b) for studies of policy transfer that involves transfer between developed and developing countries in areas other than taxation.



countries in his study of the proliferation of the VAT since it was first introduced in France in the early 1950s. Sharman's study of the adoption of tax blacklists also included developing countries which demonstrated unreflective transfer by these countries. Stewart's study involved transfer of tax ideas to developing countries under structural adjustment (Stewart 2007). Using Ghana's tax reforms as a case study, Stewart demonstrated the important role that intergovernmental organisations (IGOs) such as the IMF and the World Bank played in reforming tax policy through structural adjustment programs for developing countries. These studies are explored in more detail in the following sections. In short, it can be said that there is relatively little research on the policy transfer process from developed to developing countries in relation to taxation.

### **1.2.2 Where is the transfer from?**

Three levels of governance can be implicated in policy transfer (Dolowitz 2000a, p. 24): international, national, and local. Searching for solutions to government problems is not a random process. The easiest place to search for a solution may be within one's own country (Rose 1993, p. 97). Rose pointed out, however, that policymakers are embedded in a multiplicity of networks based on proximity and power relationships that influence where policy-makers look for ideas and lessons (Rose 2005, p. 47).

Ideological proximity emerged as a factor in policy transfer in the studies of Ashworth, Geys and Heyndels (2006), Baturu and Gray (2009), Ellis (2009), and Martin (2010). John Ashworth and his colleagues found that 'the closer ... the ideology of those authorities that have adopted the tax to the ideology of a given authority, the more likely

it is that the authority will adopt the tax' (Ashworth, Geys & Heyndels 2006, p. 242).<sup>21</sup>

In the same vein, Joseph Ellis, in his study of the adoption of the flat tax in Slovakia and the Czech Republic, concluded that: 'The 'idea' of the flat tax also was wedded to certain *ideological considerations*, which made its adoption only possible by those center-right groups' (p. 2, my emphasis). Baturo and Gray (2009), also examining the adoption of a flat tax regime in Eastern Europe, produced findings consistent with Ellis's. They suggested that in the presence of the right ideological environment, policymakers will learn from other countries' successes with the flat tax and move to adopt the policy. In relation to political ideology and its effect on policy diffusion, Martin (2010, p. 20) argued for a more nuanced form of diffusion, conditional diffusion, depending on the ideology of the government that can potentially be influenced by the transferred policy.

Psychological proximity due to shared identity or common interest is relevant to why a jurisdiction adopts a policy from one jurisdiction rather than another. Psychological proximity refers to the feeling of comfort that occurs when policy-makers from one jurisdiction interact with their counterparts in others (Rose 2002, p. 8). Despite major differences in terms of legal systems and property taxation between the US and the UK, policy actors from the UK may prefer to learn from the US than from European countries. This was the case with Tax Increment Financing (TIF), an urban policy for spatially targeted economic development. The UK's learning about this policy from the

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<sup>21</sup> 'Ideology' in this context refers to systems of ideas (especially to social, political or religious ideas) shared by a social group or movement (van Dijk, 2000). According to van Dijk group members who share 'similar' ideology stand for a number of very general ideas that are at the basis of their more specific beliefs about the world, guide their interpretation of events, and monitor their social practices. This could be communism, socialism, or liberalism. When two tax jurisdictions share these ideas they have ideological proximity.

US was attributed to, among other things, shared first language of English, shared similar urban problems and experiences, and strong personal political relations (Squires & Lord 2012, p. 819) that make actors from both countries psychologically close to each other.

The tax studies testing the importance of geographical propinquity have produced ambiguous results. Ashworth, Geys and Heyndels (2006), Cao (2010), Gilardi and Wasserfallen (2009), and Seljan and Weller (2011) showed that tax reforms in neighbouring jurisdictions influenced tax policy transfer. In examining the adoption of a green tax, Ashworth Geys and Heyndels (2006) found that it was more likely if one's neighbours already had adopted the tax. Similarly, Gilardi and Wasserfallen (2009) found in their study of tax cuts for high income earners in Swiss cantons that tax cuts were more likely among neighbours. However, in their study on the adoption of R&D tax credit policy in the US, Miller and Richard (2010) concluded that there was a negative relationship between having a high percentage of neighbouring states that had already enacted the policy and transferring that same policy to a new jurisdiction. They argued that rather than looking to neighbouring states, a state will look to the policies of economically similar states.

Separating geographical propinquity from psychological similarity is not an easy task. The two are likely to be confounded in many situations due to common history, experience of cooperative ventures, and interests. In examining the adoption of a capital tax, Cao (2010) found that 'closeness' between two countries affects tax policy diffusion. Closeness in Cao's study included geographical proximity as well as other network effects, such as cultural ties, capital flows, trade, and connection of IGOs.

### **1.2.3 Who is involved in the transfer process?**

The studies reviewed here provide insight into the answer to the second question from the Dolowitz and Marsh model: Who is involved in the transfer? Political leaders emerge as important actors in the studies of Baturo and Gray (2009), Eccleston (2006), Ellis (2009) and Miller and Richard (2010). Political leaders championed policy transfer after learning what ‘allied’ leaders were doing and how they were facing shared problems. Political leaders were important in deciding on the timing of the introduction of new policy, depending on election cycles, political agendas, environmental circumstances, domestic budgetary concerns, and political priorities. In their study of the adoption of a flat tax across post-communist countries in Eastern Europe, Baturo and Gray (2009) demonstrated how political leaders in the countries realised that in an environment where ‘a tangle of rules and little previous history made tax payments erratic at best’ (p. 132) due to the past political system, the aim of the tax reform was to widen the tax base through increasing compliance and attracting foreign capital. Estonia initiated a flat tax of 26 per cent in 1994 as part of comprehensive tax reform. Since then, 15 post-communist countries have enacted a flat tax in 13 years (1994–2007). Slovakia adopted a flat tax in 2004 and its then Prime Minister, Mikloš Džurinda, frequently cited Estonia’s then Prime Minister, Mart Laar, as his mentor in this regard (see also Ellis 2009, p. 18).

Epistemic communities also play an important role in policy transfer. An epistemic community is defined as ‘a network of professionals with recognised expertise and competence in a particular domain and an authoritative claim to policy-relevant knowledge within that domain or issue-area’ (Haas 1992, p. 3). In his study of the proliferation of VAT, Eccleston (2006) presented evidence pointing to the existence of

an international epistemic community of senior economic policy officials around the OECD which served as the basis for a policy transfer network. The role of the epistemic community, in this case the IMF's Fiscal Affairs Department (FAD), in advising the implementation of a VAT is so substantial that 'half of all countries which have introduced a VAT during the last twenty years [make] use of FAD (The IMF Fiscal Affairs Department) advice' (Ebrill et al. 2001 as cited in Eccleston 2006, p. 10). In the European Union, Radaelli's work (2000) showed the role that an epistemic community played in tax reform among EU countries.

Cao (2010), Eccleston (2006), and Ward and Cao (2012) also demonstrated the role of supra-national institutions such as the OECD and the IMF in disseminating specific policy agendas. Cao's work (2010) outlined the role that IGOs such as the IMF and the EU played in driving policy changes in capital taxation. Ward and Cao (2012) showed the role of trade and environmental IGOs in promoting the adoption of a green tax among OECD members. In the context of the adoption of the consumption tax, Eccleston (2006) pointed out the significant role that the IMF played in recommending VAT-style consumption taxes to transitional and developing nations and introducing the taxes to OECD members. The work done by epistemic communities in spreading policy is evident in Stewart's (2007) study. Conditions and rules that were established by international organisations such as the IMF, the World Bank, or other regional economic organisations had a significant impact on tax policies in developing countries (Stewart 2007, p. 183). More specifically, the role of 'think tanks' (Stone 1996) such as Crown Agents (UK) or the Harvard Institute for International Development (USA) were prominent in designing Ghana's VAT policy (Stewart 2007, pp. 192–193).

#### 1.2.4 Why transfer?

The transfer literature has shown that preferred solutions to problems are not always a rational choice, but rather are often tightly bounded (see also Marsden & Stead 2011). As Dolowitz and Marsh put it: ‘Despite the assumption of rationality inherent in most studies of policy transfer, it is rare that actors are perfectly rational’ (2000, p. 14). The selected studies reveal a range of motives for policy transfer in taxation.

International tax competition is one factor that motivates national policymakers in some jurisdictions to move towards neoliberal tax policy. Swank’s (2006, p. 873) study on the spread of neoliberal tax policy shows the presence of this notion:

The diffusion of the neoliberal tax regime was driven by tax policy changes in the United States ... Policymakers in other nations say they were quite concerned with the tax competition for mobile assets with the United States that was implied by the structural change in tax policy....

Gilardi and Wasserfallen (2009) suggested that tax cuts to wealthier taxpayers for political or ideological purposes could be disguised as rational economic policy for the benefit of the region. Tax cuts for supposedly competitive reasons were interpreted as a rationalisation to defend a policy of elite tax cuts that would be unpopular with the larger electorate. As noted earlier, Ashworth, Geys and Heyndels’ (2006) study on the adoption of a green tax in 308 Flemish municipalities found that a green tax was more likely to be adopted if neighbours adopted it and if governments were more left-oriented and were not facing elections that year. In general, the idea that states want to appear modern and adopt policy in line with other governments of an appropriately progressive or conservative nature remains plausible. The studies in policy diffusion and transfer in taxation cited here are less supportive of explanations that are strictly in line with a

rational analysis. Objective and economically relevant characteristics such as population size, environmental problems, and fragmentation of government, proved non-significant in predicting the likelihood of setting the green tax in Ashworth and his colleagues' study for instance. The findings of Radaelli (2000) on the Euro single currency, media ownership policy and tax policy highlighted the importance of strategy and power in setting in train a process of copying and adopting policies recommended by the European Commission.

Competition to attract capital featured as a motive in Barthel and Neumayer's (2012) study of the diffusion of double taxation treaties (DTTs). They suggested that while net capital importing countries can face a considerable loss of tax revenues when entering DTTs, they will look toward and are influenced by the policy choices of other focal countries and will follow their DTT activity in order to gain a competitive advantage in terms of attracting foreign direct investment.

A political imperative to take action on international tax evasion has been a motivation for the transfer of national tax blacklists. An interesting finding of Sharman's (2010) study was that the adoption of tax blacklists, rather than depicting a learning process, normative mimicry or market pressure, reflected the 'political imperative to "do something" about tax evasion' (p. 621). Sharman demonstrated through the data he collected that jurisdictions had unreflectively copied from other jurisdictions' lists (see also Sharman & Rawlings 2006). This situation led to what Sharman termed dysfunctional policy transfer (Sharman 2010). Sharman argued that pressures such as domestic economic crises (e.g., fiscal crises) and popular discontent give rise to such shortcuts for countries to develop national tax blacklists. Compiling blacklists of tax havens is an action that a government – which is facing fiscal crisis – can adopt to avoid

a backlash from the public. The backlash would be expected if the public saw the government as doing nothing in response to anger toward tax havens that are blamed for creating revenue loss.

Economic coercion in the form of loan conditionality was identified as the reason why Ghana engaged in tax policy reforms (Stewart 2007). Faced with the problem of declining revenue, Ghana's government turned to the IMF to obtain a loan. In return, some conditions were required. Tax reform was one of the conditions the IMF required; it was intended to increase revenue by, among other things, establishing an autonomous revenue agency. It is common for developing countries to be the recipient of transferred policies under the pressure of external actors. In the Indonesian context, tax administration reform was undertaken in 2002 as the condition required the IMF before it was willing to provide a loan (Brondolo et al. 2008).

The introduction of the HWI unit in Indonesia, however, has a different story. Coerciveness in the transfer is less evident in the adoption of the HWI initiative at international level. Pressure to transfer a policy that is regarded as successful elsewhere emerged domestically. In a more indirect way, an OECD document on managing tax compliance of HWI taxpayers also influenced Indonesia's tax authority to adopt a HWI policy (for more discussion about OECD's recommendation for tax authorities to establish a unit dedicated to wealthy taxpayers see OECD report on this subject (OECD 2009a).

### **1.3 Policy transfer of the HWI unit: what the literature teaches**

The main question that my research sought to answer was why the HWI initiative adopted in Indonesia failed to build cooperative relations with high wealth individuals,



improve individual tax collections from HWIs and build cooperative taxpaying relations with Indonesian taxpayers more generally. In doing so, demonstrating the occurrence of policy transfer and how it occurred was one of my first objectives. Another objective was to offer a nuanced understanding of why the transfer occurred and how it was implemented. The policy transfer literature, together with the convergence and diffusion literature proved useful in providing part of the answer to this second objective. However, the rest of this chapter shows that further elaboration of these models is required to understand why the fate of the HWI unit unfolded as it did.

One useful way of developing the framework used in this thesis is to revisit the question of ‘how deep’ a policy was transferred (Dolowitz & Marsh 1996; 2000), that is, degrees of transfer. This question focuses on how reflectively the transfer was carried out, ranging from the simplest form of transfer – copying a program from others – to synthesis where different elements from different programs are examined and are combined in order to create a distinctive and new program (Rose 1993, pp. 30–32). The latter requires a deeper degree of reflection on the policy in question than the former, especially on what elements of the programs are suitable for the local setting. This question can also be answered by looking at whether a policy transfer is merely a case of policy emulation or of policy learning. Unlike policy learning, where consequences of a policy are thoughtfully considered, emulation tends not to involve much attention to the detailed consequences of the policy. What can matter in policy emulation is the symbolic and socially constructed characteristic of policies (Cao 2010; Maggetti & Gilardi 2014). In this thesis, I argue that the adoption of the HWI initiative in Indonesia can be seen as having elements of emulation and too little investment in reflection. This may affect policy outcomes. For instance, an argument can be made when a policy

transfer occurs predominantly through a process of emulation rather than learning, the chance of the policy failing to meet desired outcomes is quite likely.

Related to emulation rather than learning is whether the transfer was part of a voluntary process (at one end of the continuum) or part of a coercive process (at the other). Knowing what drives actors to engage in the process of transfer helps explain why a particular policy is transferred inappropriately in a certain situation (Dolowitz 2000a, p. 12) and why emulation might replace reflection and learning.

Coercion and voluntariness are usually used in the policy transfer literature to indicate how much influence outside actors have in the adoption of a 'foreign' policy by a recipient country. I broaden the terms to cover both the adoption and implementation of a policy.

Moreover, coercion and voluntariness are considered to operate at different levels. It is useful in explaining not only how much pressure was received from external sources to adopt a certain policy, but also how much pressure was exerted domestically to influence the decision to adopt HWI policy in Indonesia. International and domestic pressures are both factors that need to be considered to explain why actors engage in the HWI transfer process. Both are implicated in explaining policy outcomes.

Table 1.3 illustrates different possibilities for sources of pressures to engage with policy transfer. This table expands the straight-line heuristic continuum in the policy transfer literature (e.g. Dolowitz 2000a, p. 13; Dolowitz & Marsh 1996; Dolowitz & Marsh 2000) and highlights the possibility of differentiating pressures at different levels (domestic, international) that may drive policy transfer and implementation (e.g., IGOs,

International Financial Institutions (IFIs), foreign countries). In this table, domestic elements (e.g., incumbent government, dominant political party, the general public and NGOs) feature alongside international pressures as drivers of the policy transfer process.

**Table 1.3 Possible Sources of Pressures to Engage with Policy Transfer**

Pressure	The existence and significance of pressures (from different sources)	
	Domestic	International
	No (insignificant)	No (insignificant)
	Yes (dominant)	No (insignificant)
	No (insignificant)	Yes (dominant)
	Yes (dominant)	Yes (dominant)

At the top level of Table 1.3, transfer occurs purely voluntarily in the sense that there are no pressures from either domestic or international actors, or if it does exist it is insignificant. Actors involved in this kind of process make decisions to adopt policy from elsewhere consciously, exercising choice over the policies they will adopt (Dolowitz 2000, p. 12). This is an ideal condition of transfer which probably is very rare. When transfer occurs through this process, involved actors have more time, are more willing, and are motivated to learn about the policy. Aspects of the policy in its originating setting are more likely to be thoroughly examined in order to find which parts are suitable for the local context, which are not, and which are able to be adapted to make it work in the local context.

As shown at the bottom of Table 1.3, transfer can occur through coercion. Actors involved in the policy transfer receive pressure from both domestic and international actors. Coercive mechanisms of policy transfer may be in the form of direct imposition

by other countries or IGOs. Government or other powerful agents can exert domestic pressure. Coercion may be in the form of a government making demands for a quick measure to secure a political agenda. At an organisational level, pressure may come about in the form of high expectations from senior officials without providing sufficient resources and supports.

The second and third levels in Table 1.3 describe contexts where pressures for policy transfer are predominantly domestic and predominantly international respectively. That is, when domestic actors (president, dominant political party, NGOs) exert pressure that leads to the adoption of policy from elsewhere (second level); or, when international actors pressure a certain country to adopt a policy.

#### *The case of Indonesia*

In this thesis I argue that the pressure to introduce the HWI unit was high domestically, both at the political level and at the organisational level. Internationally, the pressure was lighter but not negligible. Acceptance of international pressure was more voluntary than coercive.

The literature reviewed in this chapter provides many illustrations of pressures that occur nationally, associated with political and economic cycles, the political agendas of governments, and epistemic communities operating within nation states (Baturu & Gray 2009; Christensen 2013; Eccleston 2006; Ellis 2009; Sharman 2010; Swank 2006). All of these dynamics are informative for understanding the adoption of the HWI unit in Indonesia.

The literature also provides glimpses of the importance of what happens within bureaucratic organisations as they try to design and implement policies. Christensen's (2013) study, although its focus is national, clearly indicates the importance of events at organisational level that contributed to the diverging trajectories in the tax policies of New Zealand and Ireland. Christensen argued that differences at the administrative institutional level in who is recruited to be a civil servant and how they are trained to operate can give rise to profound differences in the direction of tax policy change. Christensen's study resonates strongly in the context of Indonesia's DGT introducing a HWI unit in the mould of the HWI unit introduced by the ATO.

The literature discussed above about sources of pressure for policy transfer leads to the supposition that on the domestic front, the HWI policy in Indonesia was transferred due to an imperative to 'do something' in front of domestic stakeholders. The directive to do something came from government. The suggestion to experiment with a HWI initiative came from DGT (evidence supporting this claim is presented in Chapter 5). The time frame for offering the suggestion was short. Once accepted prior to the general election in Indonesia of 2009, the HWI unit was introduced hurriedly to satisfy powerful actors who set high expectations for what it would deliver and how quickly it would deliver. As revealed in Chapter 5, the HWI unit was to be a quick-wins program offered by the DGT as part of the President's broader campaign to undertake bureaucratic reforms in Indonesia.<sup>22</sup>

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<sup>22</sup> The quick-win program is an initiative launched by President Susilo Bambang Yudhoyono (SBY) in which every government agency was asked to nominate a flagship program. The program's outcome should be perceived by the public in a short-term period.

The international story of the transfer of the HWI unit introduces more voluntary elements. Assistance and advice around the idea came from the OECD's FTA. Recommendations for 'best practices' to deal with HWI taxpayers appeared in an OECD report (OECD 2009a), in which experiences from countries that had already implemented some or all of those practices were presented. In regard to implementation, help came from the IMF and Australia, a near neighbour with close economic ties.<sup>23</sup> In this chapter I provided examples of how these pressures have operated in other tax contexts. Previous research has illustrated how international influence and assistance is shared through epistemic communities that cohere around IGOs like the EU, IMF, OECD and World Bank (Cao 2010; Gilardi & Wasserfallen 2009; Radaelli 2003; Stewart 2007; van Stolk & Wegrich 2008).

In the tax area, as in other economic and financial areas, international comparison is difficult to avoid. I have argued that while the international level incorporates pressures to be economically competitive, it also stimulates, particularly for developing countries, pressure to be a modern state.

In this chapter I drew on the convergence literature to show that policy transfer internationally can be driven by the perceptual need to join world society. Actors in the adopting country fear being seen as laggards if they do not adopt policy that is regarded as best practice. The policy convergence theory of the world society model (Meyer et al.

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<sup>23</sup> Since the major financial crisis experienced by Indonesia in the late 1990s, the Australian and Indonesian governments have worked collaboratively in the area of economic governance. The economic partnership between the two countries is manifested by the establishment of the Australia Indonesia Partnership for Economic Governance (AIPEG). AIPEG is aimed at improving the quality of Indonesia's economic management. AIPEG undertakes collaborative activities in institutional strengthening and provides technical advice in several areas including: tax administration reform, financial system stability, trade, and public financial management (AIPEG 2010a).

1997) is relevant to Indonesia. On the eve of a presidential election, the hope of Indonesians for a first-world system of democratic governance was attractive electorally. Part of that hope in the adopting country was an expectation for positive world-wide recognition of their systems (e.g., taxation system, educational system, election system) as best practice policy.

With forces of coercion and voluntary adoption at play, the question must be asked whether, in the policy transfer of the HWI unit in Indonesia, the process of emulation dominated the process of learning and thereby handicapped the unit from the beginning. Did the domestic imperative demanding that governmental institutions, including the DGT, 'do something' to satisfy powerful actors and, internationally, to earn recognition for conforming to a world society model of tax administration, place so much pressure on tax officials that learning became impossible and gave way to unreflective emulation?

With these ideas in mind, I present two broad orienting hypotheses formulated from the literature to guide analysis and data collection. These orienting hypotheses are not as specific as hypotheses in the scientific literature, but they reflect a direction that the analysis can take based on the literature.

Hypothesis 1(a): *Policy transfer of the HWI initiative in Indonesia occurred due to a political imperative to 'do something' to satisfy powerful actors who used the policy to advance their political agenda, of being recognised as having a modern bureaucracy.*

Hypothesis 1(b): *Policy transfer of the HWI initiative in Indonesia had elements of both coercion and voluntariness. Coercion was strongest at the levels of*

*the national government and the administering organisation, the DGT. Voluntariness was accompanied by active enlisting of advice at the international level from the epistemic community of tax experts. This mix of pressure had implications for how much learning as opposed to emulation could take place.*

In the next chapter I will elaborate and refine the learning and emulation hypotheses foreshadowed in the above discussion.

Dolowitz and Marsh (2000, pp. 18–20) have distinguished uninformed, incomplete, and inappropriate transfers to illustrate unsuccessful transfer, because of lack of information about policy being gathered by the adopting country (uninformed transfer), or when important elements of the policy in the originating country were not transferred (incomplete transfer), or when not enough attention was given to the differences in structure between transferring and adopting country (inappropriate transfer). All of these factors are relevant to the Indonesian case of setting up a HWI unit, but there were also different pressures for change at different levels of the organisations, the state and internationally with different bodies of knowledge and understanding. In particular, as will be addressed in the next chapter, it is helpful to recognise that emulation can be happening at some levels, learning at others, but that these processes may be occurring in quite different spheres of government activity.

## **Conclusion**

This chapter contains a review of selected literature on how a policy in one jurisdiction can be adopted in another. I identified the universalities of the challenge of collecting tax from HWIs in a globalised world where capital is mobile. The globalisation



literature draws attention to the adoption of very similar policies in very different jurisdictions, the root cause being structural constraints imposed by a global economic system. A race to the bottom in offering attractive tax conditions to large corporates and investors exemplifies one side of this argument. The other is a race to the top to be seen as part of the group of prosperous, advanced, developed democracies. Indonesia now thinks of itself as an important member of the G20 – a club of the most important economies in the world. The idea of nation-states striving and competing to be modern and to have best practice is an important motivational lever for change described in the globalisation and convergence literature. This presents a plausible explanation for why Indonesia was interested in establishing a HWI unit within its tax administration.

Also valuable is the policy diffusion literature, which sheds light on the reasons why one nation would follow another in adopting a certain policy while others do not. The diffusion literature demonstrates a complex set of factors that explain adoption of a policy in one polity. These factors span domestic/local, national, and international spaces and can be operating simultaneously.

Broadly speaking, the central argument of the policy convergence and diffusion traditions is that given a set of global pressures and structural constraints, a rational economic analysis, with efficiency being the prime objective, will lead to certain options universally gaining ascendancy as attractive solutions. The legacy of the diffusion literature is to demonstrate empirically that efficiency and rationality do not necessarily trump other considerations in policy adoption. Power and social influence through political leaders and epistemic communities became the focus of research attention in the wake of diffusion studies which uncovered signs of their importance.

The policy transfer framework provides a richer analytical tool than is provided through diffusion studies to explore how and why policy is transferred from one jurisdiction to another by revealing the complex set of interactions that explains policy transfer in a particular case. A more nuanced explanation of policy outcomes can be gained by using the framework as an independent variable. However, for understanding processes that may lead to failure, the notions of uniformed, incomplete, and insufficient transfer offered by the framework are too broad. It requires other variables to accommodate different actions and understanding operating at different levels and in different spaces where policy is being discussed, designed, and implemented.

The success or otherwise of policy transfer can be explained from the perspective that different pressures occur at international, national, and organisational levels from the decision to transfer through the implementation phase. This contributes to different processes of transfer in different spheres of government activity: learning at some levels, emulation at others. Appreciation of these different kinds of pressures is necessary to understand the fate of the HWI unit in Indonesia.

The concepts of 'principles', 'mechanisms', 'actors' and 'webs of influence', be they oriented to control or dialogue (Braithwaite & Drahos 2000), are discussed in the next chapter to help explain why emulation trumped learning in adopting and implementing the HWI unit in Indonesia.

# Chapter 2

## Policy Transfer: Principles, Mechanisms and Actors and Their Application to Indonesia's HWI Unit

*...it is often easier to fight for principles than to live up to them.*

(Adlai Stevenson's speech to the American Legion convention, New York City 27 August 1952, cited in Safire (2004, pp. 79–80))

### Introduction

Tax policy has bridged developed and developing countries for many decades. International taxation networks involving tax administrators and tax professionals pre-date more recent responses to globalisation that have put pressure for convergence on nation-states (e.g., Cao 2010; Christians 2010; Deprez 2003; Pinto & Sawyer 2009; Pinto & Sawyer 2011). Chapter 1 introduced some organisations that provide the institutional bridges for OECD, Asian, and Commonwealth countries. Forums include the International Tax Dialogue (ITD) initiated by 'organizations of states' (Braithwaite & Drahos 2000, p. 24) such as the European Commission (EC), Inter-American Development Bank (IDB), IMF, OECD, World Bank Group and *Centre interaméricain*

*des Administrateurs Fiscaux* (Inter-American Centre of Tax Administrations – CIAT), FTA, CATA, and SGATAR. These forums provide space for discussion of common problems and developments of new solutions among national tax officials, international organisations, and a range of other key stakeholders. Their business is to share knowledge, provide a retreat to brainstorm problems, encourage harmonization where it will be of economic benefit, and assist jurisdictions with coordination challenges that increasingly have come to the fore with globalisation. All tax jurisdictions have been affected by international companies, HWIs with multiple residences, mobile capital and other manifestations of globalisation, as discussed in Chapter 1.

Because of the high level of networking that has traditionally existed across tax jurisdictions, it is unlikely that any policy transfer occurs without engagement with some networks. Reasons for engagement in network discussion around HWI taxpaying are likely to be multiple: the need for nation-states to conform to a world-wide model, desire to be an early adopter of innovative strategies (at the international level), or an acute domestic problem that governments want solved, including a political imperative to ‘do something’ (national or domestic pressures). In this thesis, however, the main theme is not why a particular policy has been transferred, though the reasons for Indonesia’s interest in an HWI unit are discussed broadly in Chapter 5 as part of my argument for why Indonesia’s HWI unit should be seen as a case of policy transfer. Once this argument is made, my main focus is addressing the question of how the HWI initiative in Indonesia was adopted and implemented and why it did not meet its potential.

In this chapter I consider first the meaning of an unsuccessful policy transfer or one that does not meet its potential. Next, attention is given to the implementation process as

opposed to the decision-making process in introducing an HWI unit to Indonesia. It is postulated that these two processes need to be understood in order to explain the success or otherwise of the Indonesian HWI unit. The framework chosen for understanding the decision-making and implementation process is an adaptation of Braithwaite and Drahos' (2000) globalisation of business regulation model, originally developed for understanding the spread of regulatory practices internationally. The Braithwaite and Drahos model is a process model in the tradition described by Marsh and Sharman (2009) and Radaelli (2000) in Chapter 1. The model identifies the social dynamics that enable some ideas to catch on while others do not.

Braithwaite and Drahos applied the concepts of actors, principles, mechanisms and webs of influence to show how micro-level social processes contribute to produce a macro-level event such as the globalisation of a system of regulation. The relations among principles, mechanisms, and actors also have intuitive appeal for understanding how successfully or unsuccessfully policy is transferred at an organisational level. This involves applying the concepts of principles, mechanisms and actors at a micro-level of analysis (Rhodes & Marsh 1992, p. 12), and showing how these concepts explain the way in which HWI initiatives are implemented within a particular tax authority and why forms of implementation differ across jurisdictions.

This way of looking at the introduction of the HWI unit in Indonesia has parallels in Eccleston's (2006) analysis of VAT and its adoption across both developing and developed countries. In his study of the proliferation of VAT-style taxes in the second half of the 20th century, Richard Eccleston maintained that macro elements tend to imply policy transfer that leads to policy convergence, while micro elements such as the engagement of involved actors, combined with domestic political and economic

circumstances, cause variations in how the policy is implemented (e.g., when VATs were introduced, the rates at which they were levied, and how they are administered (Eccleston 2006)).

The Braithwaite and Drahos model is used to analyse the operation of the HWI unit in Indonesia to answer such questions as: who were the instigators and designers of the unit and who was recruited to work in the unit (actors), what was the purpose and priority of the unit and what were the pros and cons behind its introduction (principles), and how was the unit to operate within the DGT (mechanisms)? It is hypothesised that events at the decision-making level and at the level of implementation were not always in step. In Braithwaite and Drahos' terms, the webs of dialogue involving actors, principles and mechanisms at the level of decision-making were not always consistent with what happened at the implementation. These two phases (i.e., decision-making and implementation) were connected through a web of control from the top of the organisation reaching down to the bottom, but the control was not enough to ensure learning and successful implementation. A model developed to guide the research and the discussion in this chapter appears later (Figure 2.1). First, however, I present a discussion of the terms for deciding whether a policy transfer is a success, followed by a discussion of why implementation is significant for understanding the success or otherwise of the HWI unit.

## **2.1 How to decide whether or not a policy transfer was a success?**

A policy introduced into a new environment does not always function as it does in its originating place. This is not to say that a policy that was transferred from other jurisdictions has to be exactly the same as that in its originating country; it is difficult to imagine a policy that has this characteristic. Different policy environments require

policymakers to make adjustments to the initial form of the policy, especially if the policy is adopted from a country that has many structural differences from the borrowing country's conditions. Even when a policy is transferred between two countries that have many similarities, it does not mean that the policy is ready to use without any adjustment. When New Zealand adopted a Health Service Taskforce and the associated changes in its health policy, it was evident that the policy had an explicit link to initiatives in other jurisdictions (Jacobs & Barnett 2000, p. 210). Nevertheless, it was also noted that some aspects of the policy were different from initiatives in the Netherlands, the UK, or the US from where the policy lessons were drawn. Adjustments were made to the policy when local technical and political conditions did not facilitate the adoption of the 'foreign' model.

The review of the policy transfer literature in the previous chapter shows that transferring policy from other jurisdictions can bring about different consequences from those intended. The notions of uninformed, incomplete, and inappropriate transfers introduced by Dolowitz and Marsh (2000, pp. 18–20) describe how one jurisdiction can struggle when transferring policy from another. They relate to different reasons for failure, but do not directly address what success means in the HWI context. The HWI unit could involve an incomplete transfer for good reasons: it could be uninformed, being a complex innovation in some respects, and its original conception could have been entirely inappropriate. This does not mean, however, that it could not have edged its way toward making a significant contribution to improved tax collections from HWIs through a series of experimental modifications (Sabel & Zeitlin 2012).

Explaining the success or otherwise of policy transfer can be seen from the perspective that different pressures are being exerted at different levels: when the idea about the

policy was introduced at global level; when the idea to adopt a policy was raised, and when the policy was actually transferred at national level; and, when the policy was implemented at the organisational level. I argued in the previous chapter that appreciation of these different kinds of pressures is necessary to understand the fate of the HWI unit in Indonesia. At each of these levels, success and failure can be described in terms outlined by Bovens et al. (2001).

Bovens et al. (2001) suggested that when assessing the success or failure of a particular policy, one should distinguish between the programmatic and the political dimension of the policy. The programmatic perspective on policy success and failure evaluates policy in terms of its objectives and goal achievement and the effectiveness, efficiency, and resilience of its processes (Bovens 2010, p. 584; Bovens et al. 2001, p. 20). The key questions asked from the programmatic perspective are whether the policy achieves its intended outcomes, whether it is an efficient use of resources, and whether it is made operational in a way that is consistent with achieving its objectives (Marsh & McConnell 2010, p. 571).

The political perspective assesses success or failure of a policy in terms of political casualties and spoils that result from the policy. The political perspective on policy assessment refers to the way in which the policy in question and its policy-makers become associated in the political arena with 'political upheaval (press coverage, parliamentary investigations, political facilities, litigation) or lack of it, and changes in generic patterns of political legitimacy (public dissatisfaction or satisfaction with policy or confidence in authorities and public institutions)' (Bovens et al. 2001, p. 20). In the political mode of assessment, Bovens et al. argued, what counts is not the social consequences of policies, but rather the political construction of these consequences,



which might be driven by considerations of wholly different kinds. In short, in political perspective, what makes a policy a success or failure depends not only on its substance but upon the impressions of its appearance, which to some extent need not reflect the policy's substance and operational reality (Bovens & 't Hart 1998, p. 35). In this thesis, I make the argument for the success or failure of the policy on programmatic grounds rather than political grounds.<sup>24</sup>

In Chapter 5, the HWI policy transfer is discussed in terms of whether it achieved its objectives as specified within DGT as well as whether it was perceived by those outside DGT to have achieved its objectives. In other words, this thesis limits policy assessment from a programmatic perspective with particular attention given to policy objectives and goal achievement.

While generally attention is more on the implementation phase, the earlier phase when a decision is made to adopt a policy from elsewhere is somewhat neglected. The following section discusses the importance of the decision-making phase in policy transfer.

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<sup>24</sup> The programmatic dimension is chosen not to disregard the role of the political dimension in the success (or failure) of the policy in question, but rather to limit the analysis used in this thesis to the operations of policy, i.e. whether the policy instruments are appropriate, the skills of those delivering the policy are adequate and the resources available are sufficient to ensure that the policy is implemented as intended (e.g., Marsh and Lewis, 2014). The thesis relied on the collection of empirical data: that is, how those involved in the operations perceived events and experienced the process of implementation. Political elites were not willing to be interviewed in sufficient numbers to extend the study into an analysis of the politics behind the HWI unit's rise and fall.

## **2.2 Why is implementation as important as the decision to adopt the policy?**

Implementation requires actioning a policy within a nest of other policies that may vary in their compatibility with the new policy and within a culture and organisation that may vary in its capacity to put the policy into effect. Implementation has been an issue of common concern for tax administrations. The OECD's FTA has become a leader in defining best practice in tax administration and providing a forum for learning and exchanging knowledge and experience. The Forum has promoted the development of a service culture within tax administration (OECD 2013a; 2013b), the benefit of risk analyses of non-compliance (OECD 2009b; OECD 2009c), along with the introduction of HWI units to focus on the wealthy taxpayers group that is best resourced to evade or avoid tax (OECD 2009a). All of these developments require changes in tax administration that are traditionally hierarchical rule-book cultures (Hobson 2003, p. 148).

A large literature exists on culture change. For the purposes of this research, I discuss a more targeted literature on the challenge of implementation of new initiatives in tax authorities. The initiative that is used to illustrate the challenge in implementation is the ATO compliance model. This example is chosen because Australia introduced an HWI unit in 1996, and was an adviser to Indonesia in the modernisation of its tax administration and the setting up of its HWI unit (ATO 2010; 2011). A discussion of the ATO's compliance model is more relevant in this chapter to explain two assertions underpinning this thesis: implementation and decision-making are two different processes, both of which are important for shaping the success of a policy; and background cultural and policy factors that differ between countries affect prospects of

successful policy transfer, thereby making learning and adaptation a necessary part of the transfer process. As Indonesia looked to Australia to learn how to implement its HWI unit, Indonesian tax officials did not recognise the other changes (represented by the compliance model) that had taken place in the ATO to bolster the effectiveness of the Australian HWI unit.

### **2.3 The introduction of the ATO's compliance model: learning to deal with change**

In the 1990s, the New Public Management (NPM) movement was about market-oriented management, but also challenged public administration to re-think its relationship with communities (Gruening 2001). The NPM is the label given to a series of public administration reforms, to improve the efficiency and performance of public sector organisations (Pollitt et al. 2007). The focus was on thinking of the community as clients or customers, eliciting their cooperation with policy implementation and making it easy for them to comply.

In response to these administrative reforms, the ATO introduced several measures intended to make it more open and sensitive to the concerns of taxpayers, including the *Taxpayers' Charter* in July 1997 (ATO 1998). The charter sets principles and standards to guide tax officers in their dealings with taxpayers in the course of administering the tax system. It covers taxpayer rights, service standards, avenues of redress, and taxation obligations. In short, the charter consists of commitments that the ATO made to the public, in relation to formal ATO communications and decisions as well as interpersonal encounters (V. Braithwaite 2005, p. 7).

The other measure – perhaps more revolutionary in the change it heralded for the ATO's operations – was the implementation of the compliance model, a responsive regulatory approach for tax administration. Adopting a regulatory approach which is more responsive to taxpayers changed organisational culture and the 'traditional social order' within the ATO (Job & Honaker 2003, p. 3). It is suggested that unlike innovations that pertain to either changes in products or processes, the compliance model is an example of both product and process changes (Hobson 2003). Hobson also argued that the introduction of the model in the ATO was 'an unusual form of organisational innovation...' (p. 132) since it encouraged ATO staff to treat taxpayers as individuals who are embedded in specific contexts which, therefore, affected processes. ATO staff needed to think pre-emptively about how to write and target their correspondence, information sheets and guidance notes, affecting products. In short, the introduction of the compliance model as a new idea presented similar challenges to the introduction of the HWI unit.

The ATO compliance model was designed to change the operational approach of the ATO to tax non-compliance (e.g. Braithwaite & Braithwaite 2001; Murphy 2004a; Wood et al. 2010). Prior to the introduction of the model, the ATO relied on auditing and application of legally enforced sanctions to gain compliance. Some attention was given to educating taxpayers, but little consideration was given to a taxpayer's individual circumstances, and little thought was given to how ATO actions might endanger future compliance (Murphy 2004, p. 13). With responsive regulation, the enforcement strategy that the regulators employed was to take into account taxpayers' attitudes to compliance. This gave tax officers more room to use discretion; to be less punitive than they might otherwise have been, and also to escalate to being more

punitive than they had been. This approach is somewhat challenging for bureaucrats whose focus is on rules and discipline, narrowly interpreted as ‘conformance with regulations, whatever the situation’ (Merton 1940, p. 563), which then develops into rigidities and an inability to adjust readily to complex problems. Understanding resistance to the introduction of a responsive style of regulation with the ATO compliance model informed my work on resistance in Indonesia to the HWI initiative.

### **2.3.1 Challenges in making change**

The introduction of a new policy that might change a long-held organisational culture faces challenges because members of the organisation must change well-entrenched behaviours and practices. As a regulatory agency, tax authorities commonly adopt a command-and-control style with a focus on rule-following. Job, Stout and Smith (2007, p. 88) argued that regulation is not only about ensuring the following of rules; in a broader sense, it also means ‘influencing the flow of events’ (Parker & Braithwaite 2003, p. 119). It is important to distinguish the two approaches, since the behaviour and practices of those who pursue rule-following are different from the behaviour and practices of those who pursue the influencing of events. This was part of the challenge of the implementation of the compliance model.

The other part of the implementation challenge was a coordinated organisational shift from merely administration to management (Hughes 2012, chap. 4). Hughes argued that the difference between administration and management is that ‘administration means following instructions, whereas management means the achievement of results and taking personal responsibility for doing so’ (p. 76). This dramatic change in behaviour and culture resulted in tensions between long-held principles and new ones. In the case of the ATO compliance model, scholars (Hobson 2003; Job & Honaker 2003; Job, Stout

& Smith 2007; Shover et al. 2003) identified the challenges faced by the ATO as organisational barriers or individual barriers.

### *Organisational barriers*

Organisations' capacity to adopt and implement new policies are constrained by a variety of characteristics and conditions (Shover et al. 2003, p. 161). One of the structural barriers to change identified by Job and Honaker's (2003) study of the ATO was failure in the delivery of messages from headquarters to staff at the operational level – from high-level bureaucracy to 'street-level bureaucracy' (Lipsky 2010, p. xii). In this context, Hobson (2003) suggested senior staff played an important role in translating the idea of the compliance model into everyday behaviours for staff through informal mentoring. Job and Honaker (2003) maintained that the implementation of an innovative idea like the compliance model in a hierarchical and segmented organisation requires the introduction of procedures to ensure good communication between management and staff. Moreover, at an operational level the challenges created by a new policy will be different from those imagined at senior levels. Organisations therefore need to create staff opportunities for mutual support.

Scholars have consistently suggested that in order to create support and communication networks, an organisation must first consult fully with affected stakeholders (Argyle 1972; Hollander 1964; Wood et al. 1998). In this way, obstacles to implementation can be identified, dealt with and future problems anticipated. Proper open consultation will also provide room for participation of all staff, which in turn creates increased identification with the organisation and its goals (Argyle 1972; Hobson 2003). This is particularly important when new ideas are introduced into the organisation.

The other organisational barrier found in the implementation of the Compliance model was rigidity in observing traditional role definitions. The ATO had a long history of rigid work practices, of collecting revenue by ‘set means and seeing the taxpayers as the enemy that needs to be outwitted’ (Hobson 2003, p. 148). This mentality had to be transcended for the compliance model to be successfully implemented. Interestingly, some ATO staff thought the answer to changing culture was ‘belting [staff] over the head’ (p. 143) with the new model to inculcate the idea. The reality was that the compliance model needed to be translated meaningfully into action.

Traditionally, ATO staff followed protocols in response to a problem, not acting on their own initiative, or they followed senior staff’s instructions. Problems were noted in particular with prosecution and audit tax officers (Hobson 2003, p. 148). Traditional beliefs about how they should work and professional norms led to resistance. A further problem was that some managers resisted change, holding strongly to the principle of rule-following that had been established over a long period of time within the organisation. These old principles of regulating by the book were contested by new principles of responsiveness embedded in the compliance model. When old principles prevailed, staff members were hindered from adopting the compliance model. This was particularly problematic when old practices were favoured by senior managers. These powerful actors’ views had a strong influence on the approach that staff adopted in doing their work, and how ready and willing staff were to accept the new program (Job, Stout & Smith 2007, p. 93). It is suggested that implementing a new program that might change regulatory culture requires active, genuine, and visible support from the highest levels of the organisation (e.g., Cawsey 2012; Heuvel 2013). Moreover, the chain of

commitment to the change from the most senior officials to the most junior cannot be broken if successful implementation is to occur.

### *Individual level barriers*

Barriers to implementing a new program come not only from organisational characteristics but from individual-level concerns. At an individual level within the ATO, challenges arose from fear to embrace new ideas. The compliance model resonated with the way many ATO staff thought about people and how to motivate them, but fear came with the thought of making a mistake, lack of confidence to try doing things differently, and fear of losing their privileged status (Job & Honaker 2003, p. 120). With the introduction of responsive regulation, tax officers were encouraged to use discretion and a more flexible approach when dealing with taxpayers. As a result, 'some staff felt confused, uncomfortable, and/or angry' (Job, Stout & Smith 2007, p. 94) with the way they did their jobs. In their study of the implementation of the ATO compliance model in the building and construction industry, Shover et al. (2003) found that at the operational level there was limited awareness combined with some disappointment and cynicism about the model. Some argued that applying the law with a responsive approach may contradict 'fundamental legal principles of openness, accountability, consistency, proportionality, and procedural fairness' (Parker & Braithwaite 2003, p. 129), and concern was felt over 'the potential failure of effective and responsive regulation to secure certainty, consistency, and predictability in legal principles and values'.

At a very early stage of the implementation of the compliance model, Job, Stout and Smith (2007) reported complaints about a lack of clarity in how to apply the model to



different business situations, how to balance consistency and equity with consideration of an individual's circumstances, and how to use discretion while observing standard operating procedures (Job, Stout & Smith 2007, p. 94). The strategies that the ATO adopted to manage these problems included interactive training methods involving storytelling and case studies (Braithwaite & Wirth 2001). In this way, the concepts of responsive regulation were translated into the language of different groups within the ATO.

Shover et al. (2003) also found rigidity in adopting new ideas at the individual level when the ATO compliance model was introduced. The idea of responsive regulation adopted in the compliance model suggested the importance of persuasion, education and support in securing compliance at the first step while being ready to use sanctions when taxpayers chose not to comply. In the early years of the introduction of the model, staff with the long-held belief that a strong threat is fundamental to the compliance assurance process questioned whether the 'benign big gun' would be able to maintain an acceptable level of tax compliance (p. 167). Put differently, there was a level of rigidity at the individual level to implement a new approach that suggested that punishment should be used as the last resort when persuasion failed to bring taxpayers to comply.

In summary, the issue of implementation of an innovation in tax administration is important for the following reasons. Globally, tax authorities tend to be hierarchical and segmented in their function. They have a rule-following culture. In the case of the ATO, the compliance model threatened to disrupt this culture. Implementation of this model was made difficult by poor communication across the organisation, by managers who resisted change and staff involvement in the change program, through lack of knowledge of how to put the compliance model into practice, through fear of making

mistakes, and because of conflict between old principles (rule book mentality, social distance from taxpayers) and new principles (being responsive, treating taxpayers as customers). The ATO tackled these problems through the compliance model innovation across the organisation, which affected the operations of the HWI unit along with other parts of the ATO. Implementing Indonesia's HWI unit may have been doubly challenging because DGT had no corresponding compliance model or awareness that this innovation may have shaped the way the ATO did its HWI unit work. The HWI unit in Indonesia could not be a replica of that in Australia at the level of implementation.

### **2.3.2 What was learnt from the introduction of the ATO compliance model?**

It is highly likely that problems of the kind faced by the ATO in introducing the compliance model to their staff were also the kinds of problems relevant to the implementation of the HWI unit in Indonesia. HWI units are designed with many of the responsive features of the compliance model in mind. At a more general level, the problems involved powerful actors in the DGT, some of whom supported the change and allowed staff to embrace the change, and others who did not. There are also contesting principles in the DGT – old against new – like in the ATO. To further particular principles and make sure old principles trump new principles or vice versa, certain mechanisms were favoured. Mechanisms can also limit options for change. Mechanisms of training courses and assembling new teams of tax officers comprising educators and trainers favoured the roll out of responsiveness with the Compliance model (Braithwaite & Wirth 2001), strict adherence to templates and recording sheets based on the old rules did not (Waller 2007). It might be argued that programs that encouraged learning about policy change, as opposed to reliance on practices of

emulation, were mechanisms necessary for successful implementation of the ATO compliance model. In their study on the introduction of a responsive regulatory approach to taxation in East Timor, Job, Stout and Smith (2007) argued that changing organisational culture to shift from a command-and-control style of regulation to one of responsiveness could be done not through mental reprogramming or diffusion of an idea, but rather through translating new ideas into local context and shaping them to meet local needs. In other words, the role of a subculture within an organisation in adapting new ideas so that it is feasible to their own situation is particularly important. Similarly, learning about the HWI unit among other DGT staff was likely to be an important part of the success of the unit within DGT and through the eyes of others.

In summary, adopting a new policy is very likely to face challenges at the implementation stage at both organisational and individual levels. The challenges mainly arise from tension that occurs between long-held principles and the new principles embedded in the new policy. Understanding and accepting policy principles and how they might be reconciled with old principles then becomes a crucial element in successful implementation. In the case of the ATO and their compliance model, the principle of flexibility that underlies responsive regulation was competing with the principles of narrow rule-following traditionally used by tax officers to secure their objectives. Debating, persuading, and learning about being responsive was important, particularly among those actors who, because of their elevated position in a hierarchical organisation, have power to influence others in the organisation.

The other element that emerges as being critical from the analysis of implementation of the compliance model, and that is likely to determine the success of implementation of a new HWI policy, is good communication with all affected stakeholders. Good

communication with involved actors provides space for stakeholders to learn and participate in decision-making, which will strengthen overall understanding of the policy, its aims and processes.

## **2.4 The roles of principles, mechanisms and actors in globalisation: a macro analysis approach**

This section begins with an introduction to the concepts of principles, mechanisms, and actors and how these concepts are used at a macro-level in analysis on the globalisation of a system of regulation. As the concepts have benefit in explaining the social dynamic that occurs at the global level, they also have intuitive appeal for explaining the adoption of a policy at an organisational level. Therefore, in this section I describe my use of the concepts at the organisational level to examine the adoption of an HWI initiative in Indonesia's DGT.

### **2.4.1. Actors and the contestation of principles**

The notion of principles is different from the notion of rules, although in many cases the distinction is difficult to make (Dworkin 1967). According to Braithwaite and Drahos (2000), principles stand behind rules or are used to create rules. This idea, they suggested, is founded in the jurisprudential literature that deals with the theories of judicial decision-making and interpretation. However, different scholars have different views on distinguishing principles and rules. For Dworkin (1967) the difference between principles and rules is logical; he argued that although both set standards and point to particular decisions in particular circumstances, they differ in the character of the direction they give. Decisions that Dworkin referred to are in the context of legal obligation. Rules, he maintained, 'are applicable in an all-or-nothing fashion' (p. 25). A

principle, on the other hand, articulates ‘a reason that argues in one direction, but does not necessitate a particular decision’ (p. 26).

Joseph Raz (1972) did not fully agree with Dworkin’s opinion. Raz argued that the suggestion offered by Dworkin that a logical distinction exists between principles and rules must be greeted with some suspicion, because they play different roles in practical reasoning either in the law or outside it. Raz suggested that it is ‘the character of the norm-act prescribed’ (p. 838) that distinguishes principles and rules. He argued that whilst principles prescribe highly unspecific actions, rules prescribe relatively specific acts. Unlike rules that to some extent have a higher degree of specificity, principles can conflict (Braithwaite & Drahos 2000). Braithwaite and Drahos suggested that this conflict occurs because decision-makers assign relative weight (see also Dworkin 1967)<sup>25</sup> to the principles in question in order to reach decisions. How to weigh principles when arriving at decisions creates contestation among principles and among different actors.

After understanding the meaning of principles, the next question is: what role do principles play in the globalisation of business regulation? Principles play their role in securing objectives and goals which are important to the actors involved (Braithwaite & Drahos 2000, p. 19). Through principles, powerful actors seek to incorporate into regulatory systems and social practices changes that are consistent with or are a means to expressing their general values, goals and desires. Principles such as transparency, reciprocity and national sovereignty may give rise to quite different decisions about which course of action to pursue, depending on which has priority over another.

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<sup>25</sup> Dworkin (1967, p. 27) called it ‘the dimension of weight or importance’.

In financial regulation, for instance, the principle of conditionality is contested with the principle of national sovereignty. The national sovereignty principle suggests that ‘the nation-state should be supreme over any other source of power on matters affecting its citizens or territory’ (Braithwaite & Drahos 2000, p. 25). The principle of conditionality means that the borrower agrees with prescribed requirements set out by the lender (an International Financial Institution – IFI) in order to access the lender’s funds. In effect, the lending financial institution secures their objective by steering a nation-state’s domestic policy (e.g., budgetary, fiscal, or trade policy).

The contestation of the two principles occurs when conditions required to get access to either the World Bank or IMF development finance contravenes a borrower state’s wishes (Kovach & Lansman 2006, p. 3). In this case, the principle of conditionality takes precedence over the principle of national sovereignty.

Actors, to achieve their goals, use principles with which they are already aligned. The goals that actors want to achieve can be in different forms. In the above example, the goals that international funding actors want to achieve through the conditionality principle are, firstly, making sure that creditors’ resources are utilised effectively. In other words conditions are necessary – from the international lender’s perspective – to ‘provide assurance to the international community that borrowers will adopt adequate policies to resolve their economic difficulties ... and will, therefore, be in a position to repay the loans on schedule’ (Mayer & Mourmouras 2008, p. 106). Secondly, conditions also serve to gain the Fund or the Bank’s goal to achieve economic growth (Dreher 2006, p. 18).

Actors fight for their own principles, and against principles that they oppose. In Braithwaite and Drahos' (2000) analysis, actors were entities significant in the global context, including states (e.g., the US, France, Germany, the UK), organisations of states (e.g., the IMF or World Bank); corporations, CEOs of large companies, and government leaders.

#### **2.4.2 Applying the concepts of principles and actors to the Indonesian HWI case study**

The concepts of actors and principles can be readily applied to the context of transferring a policy to establish a HWI unit in Indonesia. My review of the policy transfer literature in Chapter 1 revealed the roles that actors such as politicians and political parties play in tax policy transfer (Ashworth, Geys & Heyndels 2006; Baturo & Gray 2009; Ellis 2009; Jensen & Lindstädt 2012; Miller & Richard 2010). Also featuring are principles and how they affect the policy and the policy transfer process. Left-right political ideology was considered in the works of Baturo and Gray (2009), Ellis (2009), Jensen and Lindstädt (2012) and Martin (2010). Other research was based on the presumption of the value of efficiency in the collection of taxes. But as van Stolk and Wegrich (2008) pointed out, efficient tax collection is not the only indicator of the success of tax administration. The principle of efficiency in tax collection is contested with the principle of integrity, which is represented by the quality of the relationship between tax authorities and taxpayers, and of service provided by tax authorities.

In the twelve months preceding the decision to introduce the HWI initiative, the integrity of the tax system was a topic of discussion in Indonesia and elsewhere (Irwansyah 2008; Barnard et al. 2007; Rubin 2011). Tax authorities linked to each other through membership of international bodies such as OECD, SGATAR, or CATA were

considering the problems HWIs posed for tax collection. Tax officials, such as those within the ATO and Indonesia's DGT, were sharing information and experiences about this initiative.

As previously mentioned, the Indonesian President initiated the idea of developing flagship programs in government agencies that became a seed for the development of the HWI initiative. DGT headquarters, with its Director General, represented actors with powerful influence to shape the interpretation of policy principles. Regional office (*kanwil*), the HWI tax service office, and tax officials were the actors at the operational level with responsibility for action to implement the policy.

Job, Stout and Smith (2007) demonstrated that tax offices are rife with capacity to fight back against a policy innovation that comes from outside. The top of the organisation may favour implementation, so might those at the bottom of the organisation, but those in the middle of a hierarchical organisation exercise significant control over the degree of uptake of the policy and the quality of implementation.

One significant problem that must be considered in relation to a conflict of principles in implementation is whether or not the principles so commonly appearing in the tax literature, particularly in documents on best practice in tax administration, have the same meaning in different tax jurisdictions. This question is particularly relevant when considering the transfer of policy and its underlying principles to a developing country. Issues relating to responsiveness, taxpayer rights, service charters, and risk analysis assume different meanings in different tax contexts. Sally Engle Merry's work on 'vernacularisation' highlights the significance of this problem (Merry 2006a; Merry 2006b). In the human rights context, Sally Engle Merry explored how transnational



ideas opposed to violence against women become meaningful in local settings (Merry 2006a; 2006b). She argued that as opposition to violence travels to different communities, the ideas are typically ‘vernacularised’, that is, the ideas are ‘adapted to local institutions and meanings’ (Merry 2006b, p. 39). It is a way to facilitate transferability of new ideas (e.g., human rights, good governance, transparency) into local contexts since ‘there is a great distance between the global sites where these ideas are formulated and the specific situations in which they are deployed’ (Merry 2006a, p. 3).

Depending on how extensively local values and practices are incorporated into transferred ideas and institutional arrangements, vernacularisation falls along a continuum from replication to hybridisation. Merry suggested that the differences between the two are a matter of degree (2006b, pp. 44–48). In translation by replication, the model from the transnational sphere sets the overall organisation, mission and ideology, whilst still giving room for local context to provide distinctive content. In other words, how ideas are acted upon in the transferred institution is shaped by local cultural understandings, but the transnational ideas remain the same. In hybridisation, vernacularisation occurs in a more interactive form in which ‘symbols, ideologies, and organizational forms’ (p. 46) of the local merge with transnational forms to produce new, hybrid institutions. Within the context of principles and policies, Merry’s work suggests that transnational ideas enshrined in principles can change as a result of those principles being blended with local values at the hands of powerful actors.

The process of vernacularisation often does not proceed easily or uniformly in the human rights context. Merry maintained that tension is caused, on one hand, by local actors’ lack of knowledge of relevant documentation and provision of the human rights

system, and on the other hand, global actors' lack of understanding of local social situations in which human rights are violated. Transnational actors are typically rooted in a transnational legal culture which is distant from local culture. In this situation, a crucial role is played by 'the people in the middle', that is, 'those who translate the discourses and practices from the arena of international law and legal institutions to specific situations' (Merry 2006b, p. 39). Merry calls them 'intermediaries' or 'translators'.

Transferring a new policy, ideas, or institutional models into a new environment is not always successful. As Merry (2006b, p. 40) suggested in the translation of human rights approaches to prevent violence against women:

New ideas and practices may be ignored, rejected, or folded into pre-existing institutions to create a more hybrid discourse and organization. Or they may be subverted: seized and transformed into something quite different from the transnational concept ... but nevertheless called by the same name.

As in the human rights arena, transnational ideas influence local practices in the taxation field. How tax administrations are structured and re-structured, how a country's tax law defines income to avoid double taxation disputes, and how tax administrations should allocate resources to monitor tax compliance of the very wealthy are all ideas that come from the transnational sphere of tax policy. Local conditions, however, still need to be considered when transnational ideas, programs, or institutional arrangements are introduced into a new environment.

In summary, in adapting Braithwaite and Drahos' (2000) conceptions of actors and principles from the globalisation of business regulation, I argue that in the process of introducing new policy within a tax jurisdiction, a range of actors will bring their own

principles to fight for as well as their own interpretations of international best practice principles. When the principles of certain actors conflict with the principles of others, contestation between principles within the organisation will occur. At times, a principle may be latent because it is so embedded in the institution. For example, collecting the maximum revenue possible is the traditional prime purpose of a tax authority, though it is not always openly acknowledged. Both the principle of efficiency and service may challenge this latent traditional mission. Or, in the transfer process, these principles may take on a local meaning or are reconciled in local ways to determine the direction of policy and its implementation. Service within an Indonesian context may imply a degree of deference that is not accepted as appropriate in more developed western democracies.

In order to pursue principles and put ideas into action in a way that supports these principles, actors look to mechanisms of implementation. Put in a different way, mechanisms are used by actors to give greater weight to some principles than others. This leads us to a discussion in the next section of the third concept adopted from the Braithwaite and Drahos model: mechanisms (Braithwaite & Drahos 2000, chap. 4).

## **2.5 The concept of mechanisms**

The concept of mechanisms helps explain how particular events come about. This approach can be utilised in the tax policy context. For instance, why did tax havens grow significantly from the late 1970s to the early 2000s (Palan et al. 2010) after the introduction of transfer pricing guidelines? Explanation through a mechanism perspective may point to the increasing demand for financial systems that provide secrecy. As Panal and his colleagues pointed out: ‘Abusive transfer pricing involves the manipulation of prices of transactions between MNEs’ [multinational enterprises]

related affiliates ... The veil of secrecy makes abuse much easier through tax havens' (p.69). A veil of secrecy is a mechanism that tax havens offer:

[p]rivacy is a key advantage to utilizing tax havens as a corporation may be able to sell its product at a lower price than its competitor, as a result of using tax havens, thereby having an overall international tax rate that is dramatically lower than its competitor (Ginsberg 1991, p. 22).

In order to explain events of globalised business regulations, Braithwaite and Drahos (2000) identified mechanisms or series of mechanisms used by actors to achieve their goals. In doing so, they focused on lower-order mechanisms, rather than on higher-order mechanisms: lower-order mechanisms are 'concrete specifications of higher-order mechanisms' (p. 16). Braithwaite and Drahos used terms such as coercion or the threat of it (e.g., economic or military coercion) to note one particular form of mechanism used by actors to gain their objectives. Other mechanisms that Braithwaite and Drahos identified in their study as 'tools that actors use to achieve their goals' (p. 17) were 'systems of reward' and 'capacity-building' (pp. 25-26).

Mechanisms connect with principles in the following ways. In the case of global financial regulation discussed earlier, lenders (IMF, World Bank) adopt the principle of conditionality. This principle guides every action they take to achieve goals when lending money to debtor countries, the goals being either to preserve their resources (Dell 1983, p. 26) or to secure international monetary arrangements through supervising members to ensure they respond to their balance of payments deficits (Williamson 1983, p. 607). In order to achieve these objectives, lenders must utilise certain mechanisms. Economic coercion is a mechanism the IFIs often use to achieve their goals (Braithwaite & Drahos 2000, p. 132). Economic coercion, as Tiewul (1975,

p. 670) pointed out, is an attempt to constrain state conduct through the threat of withholding economic resources. It may take various forms, from discreet conditionality in an onerous finance development contract to outright trade embargoes. Whatever the form, economic coercion encompasses ‘interventions in the internal and external affairs of another state using economic measures’ (Villaroman 2009, p. 8). This practice, as Dicke (1988) suggested, places economic coercion in the service of the conditionality principle in violation of another fundamental principle of international law: the principle of non-intervention in the domestic policy of a sovereign state.

The above example illustrates that there is a relationship between principles that actors weigh as important and mechanisms they employ to secure their goals. A tax authority might use training as a mechanism to ensure that an innovation like the ATO’s compliance model is fully understood. Training may be supported by champions of the model (Hobson 2003). Opportunities to use this mechanism may be blocked by those who dislike the idea of responsiveness and prefer a rule book approach to tax collection.

## **2.6 The application of mechanisms to the Indonesian HWI case study**

Mechanisms are defined pathways for achieving goals. That said, many different mechanisms can be used to achieve the same goal. As Hobson (2003) showed, ATO staff were expected to understand and use the compliance model. Some favoured a more consistently coercive mechanism to achieve change; others favoured a more consistently persuasive mechanism through dialogue.

In accordance with the discussion of Merry’s (2006a; 2006b) work earlier, mechanisms must suit contexts. Thus, similar actors with similar goals may use different mechanisms to achieve those goals depending on context. In other words, the

mechanisms favoured by the HWI unit in Indonesia are likely to be very different from the mechanisms used in Australia.

Finally, an important feature of the concept of mechanisms, as advocated by Braithwaite and Drahos, is that mechanisms used by actors are largely of their choosing. In other words, actors are conscious of utilising certain mechanisms. Actors choose mechanisms based on which one fits their needs best, just as a chef chooses which knife will be used for which food. This feature is important to note. Sometimes mechanisms are unknown to actors, such as the mechanism of natural selection being unknown to the species it affects, but in the present context, actors consciously utilise or develop mechanisms to achieve their goals.

In summary, in this thesis, mechanisms are operationally defined as measures that actors choose to employ in their effort to achieve certain goals that are directed by principles to which they strongly adhere. The achieved outcomes from applying certain mechanisms might be positive or negative. The term mechanism is used generally to take account of both possible consequences.

Although efforts have been made to examine why some transfers are a success and others are not, research on tax policies that have employed a policy transfer framework (as discussed in Chapter 1) has made limited use of the concepts of principles, mechanisms and actors (Braithwaite & Drahos 2000) as process variables in their analyses. In contrast, before commencing my data collection I undertook an analysis to identify the actors within DGT who use certain mechanisms to support principles that best served their interests or goals in the HWI context. The contest of principles

determines outcomes: in the HWI case, did integrity, efficiency, service or revenue take precedence in defining the mission of Indonesia's HWI unit?

## **2.7 Principles, mechanisms and actors**

Chapter 1 focused on the policy convergence, diffusion and transfer literatures, and revealed the importance of international, domestic, and organisational factors in whether a policy is adopted, the timing of the adoption and the form it takes. In Chapter 2 I presented an argument for why the introduction of an HWI unit can be considered a transfer undertaken with networks of knowledge support, why implementation and the decision to adopt a policy are each important for a successful outcome, and how the concepts of principles, mechanisms and actors can be used to determine the way in which the policy is put into effect.

Based on the work presented in Chapters 1 and 2 to this point, I proposed a simple 2x3 schema for the ways in which principles, mechanisms and actors operate at different phases of policy transfer and diffusion on taxation (see Table 2.1). The first dimension relates to either the decision to adopt a policy from another jurisdiction or the implementation of that policy. The second dimension represents international, domestic, and organisational/internal levels of contestation and deliberation about the policy. The concepts of principles, mechanisms and actors are used in each cell to capture the different dynamics. The discussions in Chapter 5 to 7 involving Indonesia's HWI unit traverse the cells in Table 2.1, but the main focus of this thesis is on the 'implementation-organisational' cell. It is not suggested that the principles, mechanisms and actors in Table 2.1 exhaust all possible principles, mechanisms and actors that are in play, just some of the most important ones in this empirical study. Where policies involve cultural change, are politically charged, and involve judgment and negotiation –

as HWI units do – policy success is impossible without highly skilled, motivated and knowledgeable staff. Having such staff depends on effort and resources being dedicated to the concepts in the ‘implementation-organisational’ cell in Table 2.1.

**Table 2.1 Principles, Mechanisms and Actors at Different Phases of Policy Transfer and Diffusion in Taxation**

	Adoption	Implementation
International	P: tax neutrality, tax coordination, efficiency, perceived competitive benefits	P: race-to-the-bottom, competitive advantage, political imperative ‘to do something’, economic crisis and popular discontent
	M: normative pressure, mimetism, coercion, learning, coordination	M: emulation, copying, spatial dependence, negotiated strategy
	A: multi-national corporations, epistemic community, policy entrepreneur	A: OECD, IMF, international forums, bureaucrats, IGOs
Domestic	P: economic development, political interests	P: best practice, competition, efficiency
	M: emulation, competition	M: networks, inter-personal communication channels, cooperation
	A: politicians, political institutions	A: bureaucrats, experts, businesses, IGOs, community leaders
Organisational	P: international benchmarking, service quality, customer satisfaction	P: tax appropriateness; fair, simple, and investment oriented; perceived benefits; neoliberal tax system
	M: coercive, mimetic, isomorphism	M: cooperation; rational learning; political pressure; peer pressure from neighbouring countries; training, openness of administrative institution, and open recruitment
	A: IGOs, think-thanks, trans-national administrative networks	A: The IGOs’ advisers, local bureaucrats (civil servants), officers from other countries

Source: Studies summarized in Appendix B.

Note: P = principles, M = mechanisms, A = actors. Shaded cells are the focus of this thesis.

Policy transfer frameworks usually look at the concepts of principles, mechanisms and actors – perhaps in different terms – at the macro level. That is, when a policy is in the process of being transferred from one jurisdiction to another. As mentioned earlier, in this thesis these concepts are examined at the implementation phase of the transferred policy. This is discussed in the following section.



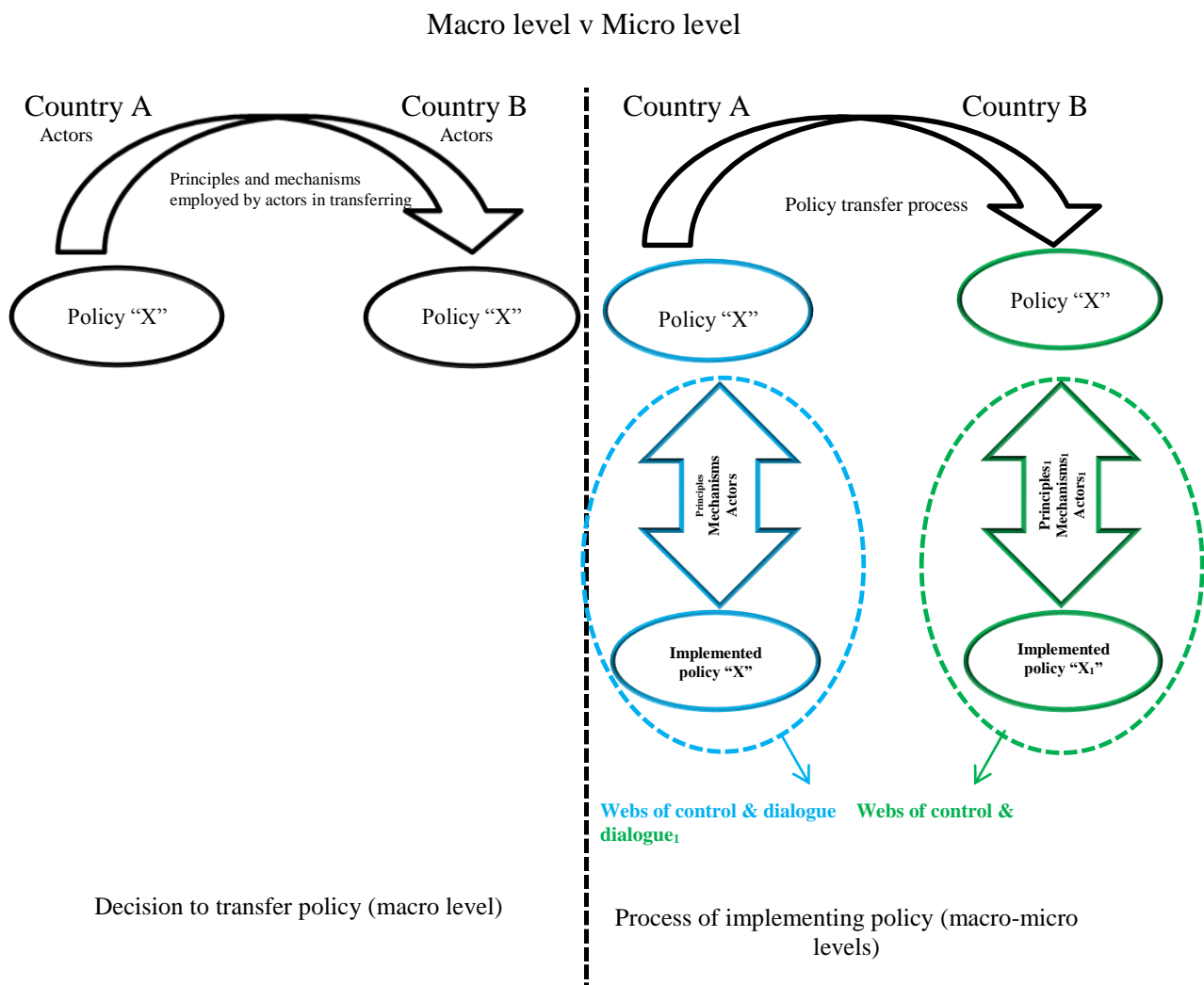
### **2.7.1 Graphical representation of the research approach**

In this section I present the model (Figure 2.1) that guided the research. The left side of illustrates, in a simplified way, the process of policy transfer from one jurisdiction to another. The transfer can involve policy goals, contents or instruments, institutions, or programs. Actors are involved in policy transfer and may include elected officials, bureaucrats and civil servants, policy entrepreneurs and experts, consultants, political parties, pressure groups, think tanks, corporations, and both governmental and non-governmental international organisations (e.g., the Tax Justice Network) and institutions (e.g., Cao 2010; Eccleston 2006; Ellis 2009; Miller & Richard 2010; Prakash & Caro 2010; Radaelli 2000). At a macro level, as Braithwaite and Drahos (2000) have argued, these actors engage with principles in a bid to influence the flow of events.

The principle or set of principles that actors can weigh up according to the tax literature on policy transfer include tax neutrality, tax coordination, fighting against harmful tax competition (Radaelli 2000), the race-to-the-bottom (Eccleston 2006), service quality and customer satisfaction (van Stolk & Wegrich 2008), competitive advantage (Barthel & Neumayer 2012; Gilardi & Wasserfallen 2009) and efficiency (Swank 2006; Ward & Cao 2012). International organisations such the OECD and the IMF promote principles of tax integrity and sustainability, among others.

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Cao 2012). International organisations such as the OECD and the IMF promote principles of tax integrity and sustainability, among others.



**Figure 2.1 Comparing decision to transfer a policy and process of implementing a transferred policy**

The right side of Figure 2.1 illustrates implementation of a transferred policy. Principles are enacted to guide and justify a particular policy transfer. In the case of the Indonesian tax administration, some of these principles might have been articulated at the most senior levels, but some would not. Among senior personnel, some might not have been consciously aware of the principles driving the policy transfer (see Hobson 2003; Job et

al. 2007 for the Australian context when introducing ATO compliance model). Whatever the levels of awareness, the policy will have embedded principles that guide mechanisms used to achieve certain goals. With the transfer of the HWI policy to Indonesia, embedded principles may not have been evenly understood across different levels of the organisation, nor evenly accepted as legitimate. Pockets of resistance were likely. The extent of the resistance and its enduring quality depended on how effectively DGT's networks of dialogue and control persuaded and informed staff of the value of the principles and the appropriateness of the mechanisms used to implement them. The next section introduces the idea of two types of webs of influence: a web of control and a web of dialogue.

### **2.7.2 Webs of influence: control and dialogue**

Understanding the operation of a web of influence, Braithwaite and Drahos (2000) suggested, helps understand how an accomplishment as difficult as the globalisation of regulation is institutionalised. Actors build global as well as local networks through which knowledge, resources, and mentalities are shared (Cartwright 2011, p. 49) and it is through these networks that actors have the capacity and power to influence the flow of events (Parker & Braithwaite 2003, p. 119). Braithwaite and Drahos distinguished two different types of webs of influence: *dialogic webs*, and *webs of control* (Braithwaite & Drahos 2000, pp. 551–552). Both types of webs are used by actors to achieve their goals, but different types of webs are associated with different consequences.

In their research, Braithwaite and Drahos (2000) found that in all cases, while webs of control (reward and coercion) were connected to dialogic webs, dialogic webs often existed without any webs of reward and coercion. Braithwaite and Drahos argued that

most actors in the world system prefer to work through dialogue before they opt for control (p. 552). Moreover, it is worth noting that webs of control are only accessible to actors who have resources to execute reward and coercion.

Webs of dialogue tend to have different consequences to webs of control because they provide greater room for communication between actors. In dialogic webs, actors convene officially and unofficially, formally and informally. Unofficial and informal forms of dialogue are important, especially in organisations that are highly bureaucratic and hierarchical such as tax authorities. Dialogue conducted in informal ways provides higher levels of the bureaucracy with opportunities to hear the ideas and insights of ‘street-level’ officials (Lipsky 2010). This kind of communication is often not possible through formal channels. The core idea of the concept of webs of dialogue is that ‘[d]ialogue helps actors to define their interests, thereby giving scope for the operation of mechanisms of reciprocal adjustment and non-reciprocal coordination’ (Braithwaite & Drahos 2000, p. 553). Reciprocal adjustment means that through ‘non-coerced negotiation ... parties agree to adjust the rules they follow’ (p. 25). Non-reciprocal coordination occurs when ‘movement toward common rules happens without all parties believing they have a common interest in that movement’ (p. 25). In short, webs of dialogue facilitate a process of building commitment and mutual understanding of shared interests that can be sustained without enforcement activity.

In contrast, webs of control do not rely on or prioritise dialogue between actors involved in the process. Actors utilise webs of control by employing a command-and-control style of regulation to achieve their goals. It is understood, however, that command and control is not the only or the best way to control coercively. Hegemony, implied threats, and incentives are other mechanisms that may be used by more powerful actors to

achieve their goals.<sup>26</sup> Webs of control reflect ‘harder’ forms of regulatory processes that deliver top down and robust forms of reward and punishment (Cartwright 2011, p. 51). In order to ensure compliance, actors who engage with webs of control usually apply coercion, the threat of coercion or reward rather than use dialogic forums to bring involved actors to the same table to talk and negotiate.

Relationships built between actors in webs of control differ from those in webs of dialogue. In webs of control, weaker actors accept prescribed regulatory goals without much questioning because they understand that negative consequences may result if they do not comply. On the other hand, they also understand that they may receive certain incentives or rewards by conforming to powerful actors’ directions. In other words, webs of control build a culture in which conformity to the process is more important than being active participants in the process (Cartwright 2011, p. 55). Moreover, as Ayres and Braithwaite (1992, p. 49) and Bruno Frey (1997) argued, the use of extrinsic incentives (rewards or punishments) undermines intrinsic motivation to comply. Although webs of control might succeed in accomplishing compliance in the short term, they are likely to fail to gain long term commitment to meeting compliance standards.

When applied to the implementation of the HWI unit in Indonesia, the concept of webs of influence together with the concepts of principles, mechanisms and actors provide a way of analysing how the directive from Indonesia’s DGT was understood and cited by

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<sup>26</sup> In the globalisation of regulation context, hegemony, according to Braithwaite and Drahos (2000, p. 26), achieves its goals ‘by actors following the lead of the dominant power because those other actors define interest in terms of those of the dominant power (without need of threat or offer of reward by the hegemonic power)’.

different groups within the HWI TSO during the implementation of the transferred HWI policy.

When introducing a new policy, there is a case for actors who have more power to use dialogic webs rather than webs of control to influence other actors to achieve goals. The ATO's introduction of a compliance model, as discussed earlier, as a new policy for dealing with taxpayers in Australia, is an example of how dialogic webs are used to elicit compliance. This is not say, however, that webs of controls are not also used under the compliance model; they are used if persuasion and education fail. In certain situations, powerful actors might still need to use webs of control along with webs of dialogue. But excessive use of webs of control by powerful actors without dialogue to explain and persuade will undermine the long term commitment of actors who are involved in implementing the policy. The use of webs of control means that communication between different levels of bureaucracy does not flow smoothly, since there are likely to be barriers between high levels of the bureaucracy and operational level staff (e.g., resistant middle managers). Therefore, I predicted that poor communication, especially with regard to the HWI policy, was one of the factors that contributed to the failure of the implementation of the HWI policy in Indonesia.

My conclusion from this exploration of webs of influence was that when webs of control dominate webs of dialogue in a hierarchical, highly segmented organisation, and when principles remain contested, then the success of implementation of a policy directed by the most senior tax officers to those operating at street level is likely to be partial at best. This insight led to the new hypothesis listed below that (in conjunction with the hypotheses listed in section 1.3) guided my data analysis.

### 2.7.3 Hypotheses in relation to implementation of the HWI policy in Indonesia

In Chapter 1 I proposed the following set of hypotheses based on my review of the policy transfer literature.

Hypothesis 1(a): *Policy transfer of the HWI initiative in Indonesia occurred due to a political imperative to 'do something' to satisfy powerful actors who used the policy to advance their political agenda of being recognised as having a modern bureaucracy.*

Hypothesis 1(b): *Policy transfer of the HWI initiative in Indonesia had elements of both coercion and voluntariness. Coercion was strongest at the levels of the national government and the administering organisation, the DGT. Voluntariness was accompanied by active enlisting of advice at the international level from the epistemic community of tax experts. This mix of pressure had implications for how much learning as opposed to emulation could take place.*

The discussion presented in this chapter gave rise to three additional hypotheses:

Hypothesis 2: *Transferring a complex policy such as an HWI unit requires flexibility in organisational structure that is able to tolerate structural changes to accommodate mechanisms required to achieve policy outcomes.*

Hypothesis 3(a): *Learning about implementation of the HWI policy requires understanding of the principles underlying the policy (particularly as enacted in Australia).*

Hypothesis 3(b): *An understanding of the principles underlying the HWI policy is essential for choosing appropriate mechanisms for its implementation.*

Hypothesis 4(a): *The use of webs of control rather than webs of dialogue by powerful actors blocked channels of communication across different levels of the organisation and with stakeholders involved in the implementation of and affected by the policy.*

Hypothesis 4(b): *Poor communication to disseminate new policy ideas such as the HWI unit resulted in poor support for the policy and an inability to learn from others with local 'grounded' knowledge for how the policy could be best implemented.*

The hypotheses place principles and contests over principles at the centre of the analysis. Policy principles guide practices and mechanisms used to achieve policy objectives. Therefore, it is important for an adopting country to gather knowledge, not only about technical aspects of the transferred policy, but about what principles exponent countries (Australia being the most influential in this case) held with regard to the policy in question. Failure to gather comprehensive knowledge about the policy leads to policy failure, because the practices and mechanisms required to achieve policy goals may be overlooked. This issue relates to Hypothesis 1.

In addition to seeking knowledge about the changes required to set up Indonesia's HWI unit, I investigated the flexibility of DGT's structure required to support the new initiative. Christensen's (2013) study on tax reform in New Zealand and Ireland found that distinctive administrative institutions in the two countries had a major impact on the



direction of tax policies. Among other factors, Christensen examined the openness of administrative institutions, which in New Zealand allowed the Treasury to recruit experts with strong economic-specialised expertise from outside the bureaucracy: foreign economists, academics, and business people (Christensen 2013, p. 570). In contrast, the closed recruitment process practised in Ireland resulted in more generalist tax policy-makers (pp. 573-574). Consequently, tax policy reforms in New Zealand and Ireland have moved in different directions: New Zealand adopted 'one of the most neoliberal tax systems in the world, whereas Ireland pursued a heterodox tax policy' (Christensen 2013, p. 579).

Openness means flexibility to adopt ideas from outside. In Christensen's study, it meant flexibility to recruit experts from outside the bureaucracy as practised by New Zealand's Treasury. In the context of my study, flexibility is required in organisational structure to tolerate structural change that may be needed to introduce mechanisms required to implement the transferred policy. This certainly is not to say, however, that these mechanisms should be identical with those of other countries. Adjustments will always be needed. However, in many cases, even a simple adjustment is not easy to make in an organisation with a rigid structure. Organisational rigidity is proposed as a factor that contributed to the HWI unit in Indonesia not meeting expectations and reaching its potential (Hypothesis 2).

A hurried and coercive transfer is likely to lead to incomplete or inadequate learning because actors responsible for implementation of the transferred policy are either doing so without deep reflection or unwillingly. Or, if a transfer is conducted only to win recognition, then actors are likely to superficially engage with best practice, with little understanding of how it works in its originating setting and what should be done to

make it work in a new setting (see for instance Dolowitz 2000a; Rose 1993; 2002).

These are the insights from the literature that led to Hypothesis 3.

Hypothesis 4 recognises that there is potential for conflict between higher-level officials, at the strategic level of the organisation, with lower-level officials at the operational levels. The conflict results from different interpretations of the principles of the transferred policy. Based on their interpretations of the principles, different actors conclude that different policy goals should be prioritised and, therefore, different mechanisms will be used as the best tool to achieve their goals. In their classic article, Dorf and Sabel (1998) suggested involvement of actors through ‘pooling of information’ (p. 287) in which actors at different levels learn from each other. In the context of my study, actors at the operational level are given more chances to participate in policy ‘refinement’ through dialogic processes. Through this process, Dorf and Sable argued, efficiency is increased and accountability is heightened as actors participate in the decisions that affect them (p. 267). However, in practice the mechanisms that will be supported and resourced will often reflect the wishes of the most powerful actors. The concepts of contestation between principles and how powerful actors within Indonesia’s DGT weigh up these principles and favour particular mechanisms provide valuable insight into why the HWI unit in Indonesia proved so unstable and unsustainable compared with HWI units in Australia, France, Japan, or New Zealand, where such units have been operating for more than a decade.<sup>27</sup>

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<sup>27</sup> In February 2012, only 34 months after its inception, the role of the HWI tax service office as a dedicated unit for administering HWI taxpayers was altered. Its name (HWI Tax Service Office) and function were changed; it became Large Taxpayers Tax Service Office IV, with a new function of administering state-owned companies (especially those in service sector) as well as HWIs (see Chapter 5 for more detailed explanation).

## **Conclusion**

Implementing a policy that has been transferred from elsewhere requires a shared understanding of the policy principles in the adopting country. As demonstrated through the introduction of a new compliance model in the ATO in the late 1990s, new initiatives are more likely to succeed when powerful actors commit to the initiative and involve stakeholders in the implementation process.

In imposing policy principles that are regarded as the best alternative to achieve organisational goals, powerful actors may utilise webs of influence they have built. By using such webs, powerful actors are able to bring other actors on board. Webs of influence consist of dialogic webs and webs of control. While webs of control rely heavily on the use of command-and-control mechanisms to secure compliance to the organisational ethos, dialogic webs give more opportunity for involved actors to share their views about the policy in question. When policy principles are understood well, accepted and shared evenly among actors involved in the implementation process, it is very likely that the policy can achieve its goals, though the goals may be different from those in other countries. Local actors, mechanisms and principles work through webs of influence to re-shape the transferred policy to fit the local setting.



# Chapter 3

## Research Methods

*Conversation is an ancient form of obtaining knowledge.*

(Kvale 1996, p. 8).

*...narration is how people express their understandings of events and experiences.*

(King & Horrocks 2010, p. 213)

### **Introduction**

This chapter describes the methodological framework used in this thesis for gathering and analysing data. The overall objective of the research was to answer the question: Why did the HWI initiative in Indonesia fail to meet its potential? In doing so, I aimed to understand the transfer dynamic that occurred at international, domestic, and organisational levels. The implementation in Indonesia of a policy adopted from a mature democracy necessarily requires considerable planning. This process was the prime focus of my research.

Chapter 1 introduced the concepts of globalisation, policy convergence, diffusion and policy transfer as concepts explaining why policies tend to be similar between countries and how one country adopts a policy (or a series of policies) from another. However, at

the implementation phase (as opposed to the transferring phase) of the adopted policy, the interaction between actors at the organisational level is important (see, for instance, Christensen's (2013) study). Understanding the interaction between involved actors through their narratives about the implementation process helps to advance our knowledge of how policy transfer can meet expectations. I discussed actors, principles, mechanisms and webs of influence that can serve as a framework for understanding the dynamics of implementation in Chapter 2, and presented the model that guided my analysis.

Dolowitz and Marsh's (1996; 2000) policy transfer framework and Braithwaite and Drahos' (2000) concepts of actors, principles, mechanisms, and webs of influence underpinned my theoretical analysis of the adoption of HWI policy in Indonesia's tax administration. These works also guided the methodology used in collecting the primary data. One of the tasks was to document how the transferred policy produced unexpected outcomes. The policy transfer framework sets the scene by recognising that a policy is transferred from one country to another for particular reasons. Hence, I sought documentation that provided evidence of intentional transfer by Indonesia and why the HWI policy was transferred. I also searched for documentation identifying the actors involved in the transfer process, how the policy was transferred, and what kinds of reflection were accorded to the transferred policy. However, in order to give a more nuanced explanation of the dynamics that occurred at the implementation stage, particularly at the organisational level, I borrowed Braithwaite and Drahos' concepts principles, mechanisms, actors and webs of influence, and applied them through interviewing key actors.

Braithwaite and Drahos' (2000) concepts of actors, principles, and mechanisms recognise that different actors engage with different mechanisms to secure principles they regard as important. Webs of influence explain relationships built between actors who have different levels of power.<sup>28</sup> Policy documents gathered during the study signalled which actors had more power and which had less. After reading the documentation, I organised a series of interviews with identified actors in order to acquire a deeper knowledge of the principles to which certain actors ascribed and what mechanisms they used to achieve their goals. Not surprisingly, these elements of what actors were trying to do, who was opposing them, and how they furthered their goals did not appear in any policy documents. Gathering information from both conversations and written narratives enabled me to identify (a) actors who played key roles in certain situations; (b) the principles to which particular actors assigned most weight; (c) mechanisms perceived by actors as the best pathways to achieving their policy goals; and (d) the form of the webs of influence actors used to achieve their goals.

### **3.1 Approach to answering research questions**

In order to answer the research questions, I collected and analysed the available documentation about HWI units, how they should be set up and how it was set up in Indonesia. Documentation included formal government papers, reports from IGOs, academic reports and research papers, and media releases and reports.

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<sup>28</sup> Power in this context refers to the possession of authority, control, or influence by which a person influences the actions of others, either by direct authority or by some other, more intangible means (Extension, 2013). From the gathered documents power of individuals was inferred from their formal level or position. This information was used to direct me to which persons should be interviewed. When suggestions were made to talk to others, I endeavoured to gain further information through requesting further interviews. Needless to say, power can be wielded out of sight or knowledge of others.

It is common for the implementation of a policy initiative to stray from formal expectations and the formal plan. Unexpected events occur, ad hoc responses are made and subsequent decisions can have consequences for how further implementation unfurls. It is therefore important to avoid sole reliance on formal documentation in an analysis of an event such as the implementation of the HWI initiative in Indonesia. Formal documentation is likely to present a picture of how things should be and provide the best possible account of proceedings. In contrast, I needed to describe and explain what actually happened. Moreover, as argued in Chapter 2, it was inevitable that different views would exist about the implementation of the HWI unit. While it was unrealistic to capture all of these views, I was committed to capturing as much of the diversity as possible. In particular, it was important to understand differences in the interpretation of the policy and how these differences in policy interpretation led to policy failure.

In order to obtain informal accounts of events that reflected the diversity of views surrounding the implementation of the HWI initiative, I conducted interviews with individuals who I expected to have direct or expert knowledge. Interviews were conducted inside and outside the ATO and DGT to gather narratives from actors involved in and affected by the HWI policy.

While an analysis of documentation and interviews with key informants provided different kinds of information, there was also opportunity to use the two sources of data as a check on the other and as a way of triangulating on findings.



## **3.2 Choosing a comparison country**

When Indonesia made the decision to create an HWI unit in mid-2009, at least 10 other countries already had HWI units operating (OECD 2009a). Understanding how these units were operating provided a benchmark against which the operation of the HWI unit in Indonesia could be evaluated. For the purposes of this research, it was unwieldy to use all ten other countries as benchmarks; instead, I used one comparator – Australia. There are three reasons for choosing Australia. First, at the time of introducing its HWI unit, Australia’s operation was regarded as cutting edge in tax administration. Australia had the reputation of successfully introducing a ‘holistic approach’ for monitoring the tax compliance of HWIs and their related entities – an approach never before used in tax administrations (Braithwaite et al. 2003, p. 205; Senate Economics References Committee 2000). Second, while the OECD led the way in urging countries to adopt an HWI unit, it was Australia that provided much of the initial advice to Indonesia (ATO 2010). Third, as demonstrated in Chapter 1, regional proximity can explain the adoption of similar policies in neighbouring states (e.g., Ashworth, Geys & Heyndels 2006; Gilardi & Wasserfallen 2009). Australia is one of Indonesia’s closest neighbours, and certainly the closest with an HWI unit in 2009.

Australia’s HWI unit was established in May 1996 within the ATO’s High Wealth Individuals Taskforce (HWI Taskforce). Indonesia’s unit was established in May 2009 and called the High Wealth Individual Tax Service Office (HWI TSO).

### **3.3 Methods in detail**

This section explains sources of data that I used in this research and how to obtain them. Methods used in this research include document studies and interviews which will be discussed in further in the following.

#### **3.3.1 Document studies**

The documentation accessed for this research was publicly available or obtained by request. I used five main sources of secondary data: data from tax authorities, data from other government agencies, data from non-governmental institutions, data from the mass media, and data from published research.

Data from the tax authorities, both the ATO and the DGT, appears in aggregated form: the growth in the number of HWI taxpayers, the growth in tax revenue from the compliance activities generated by the HWI unit, and the growth in resources utilised to manage the HWI segment. Data from the DGT also included the growth in the number of taxpayers in general (not only HWIs), the growth of tax revenue, and the growth in the number of tax return lodgements.

In the case of Australia, these data were mainly gathered through the ATO's website (ATO n.d.), which provided access to the Commissioner of Taxation's annual reports, booklets, meeting minutes, and press releases. Documentation gathered during interviews included ATO bulletins in relation to HWI operations and presentation materials about the HWI taskforce for internal and external purposes.

Other government departments and agencies in Australia from which materials were collected included the Parliament of Australia (Parliament of Australia n.d.), the

Australian National Audit Office (The Auditor General n.d.) , the Inspector-General of Taxation<sup>29</sup> (Inspector-General of Taxation n.d.), and the Commonwealth Ombudsman (Commonwealth Ombudsman n.d.).

In the case of Indonesia, I collected published material from DGT, and the MoF and its echelon I units<sup>30</sup>. Information gained from these institutions was gathered through their public websites (Ministry of Finance Republic Indonesia n.d.) and from publicly available publications and reports, or obtained by special request during fieldwork. This included data from the Indonesian budget for various years, policy documentation in relation to the establishment of the HWI unit, policy papers, memos, and meeting minutes.

In general, Australian government websites proved to be a richer source of data than the comparable Indonesian websites. This had consequences for the interview phase of the project. Interviews with Indonesian participants became a very important source of information on how and why the HWI policy was transferred.

Other sources of data utilised in this study came from non-governmental institutions, especially those with a focus on taxation or HWIs. These institutions included consultancy firms (for example, Capgemini, Boston Consulting Group, Citi Private Bank, Knight Frank) which regularly publish reports on growth in centres of wealth.

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<sup>29</sup> The Inspector-General of Taxation (IGT) in Australia is an independent statutory agency that was established under the Inspector-General of Taxation Act 2003. Its functions are to review: (1) systems established by the ATO to administer the tax laws, and (2) systems established by tax laws in relation to administrative matters (Inspector-General of Taxation n.d.). While a number of Commonwealth Government agencies examine systemic taxation administration matters, the IGT is the only agency with sole responsibility for such reviews.

<sup>30</sup> Indonesian MoF consists of 12 echelon I units in which DGT is one of them.

Also included are non-governmental agencies with a particular interest in taxation: The Tax Institute (Australia), the Indonesian Tax Consultants Association (*IKPI*), Tax Justice Network (international), the OECD, the IMF and the World Bank.

This study also benefited from publicly available research documents. In particular, I utilised an interview transcript from a program called ‘Innovations for Successful Societies’ produced by Princeton University (Princeton University 2014) with senior officials of the Indonesian MoF and the DGT. The topic discussed in the interview was the process of bureaucratic reform in the Indonesian MoF and tax administration. The interview recording and transcript are available online.<sup>31</sup>

Finally, insight into the operations of Australia’s and Indonesia’s HWI units was gained through searching the media, specifically magazines, newspapers, and news networks in both countries for articles related to the operation of HWI units.

### **3.3.2 Interviews**

#### *Recruitment of participants*

Participants were sought from two major groups: individuals with an affiliation with a past or present tax authority and stakeholders who had observed or taken part in the setting up of the HWI unit from outside the tax authority both in Australia and Indonesia. Ensuring representation from both groups was strategically important for identifying the different webs of influence that shaped the way in which the HWI unit was introduced and developed in both countries.

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<sup>31</sup> The interview materials can be accessed at the program’s website: <http://www.princeton.edu/successfulsocieties/index.xml>.

In recruiting interviewees, I followed the method of Braithwaite (2003b). John Braithwaite examined the performance of the ATO's HWI Taskforce a few years after the taskforce was established. In Braithwaite's study, participants were selected strategically because of their knowledge of and experience with HWIs (p. 246); they were not selected randomly from a pool of possible tax advisers or tax officers. I adopted the same approach. In King and Horrocks' (2010, p. 31) terms, interviewees were people who had demonstrated a systematic relation to the topic under study, that is, the taxation of HWIs and the administrative arrangements for doing so.

The strategy for developing contacts in the Australian and Indonesian tax authorities differed. In Indonesia, my position as a tax official on study leave during the course of my PhD placed me within an 'insider-outsider' research frame (Kanuha 2000). The term insider-outsider is used when researcher(s) 'conduct studies with populations and communities and identity groups of which they are also members' (Kanuha 2000, p. 439) and 'shares an identity, language, and common professional experiential base' (Asselin 2003, p. 100), but are not currently living in the context of the group (Oladele et al. 2012, p. 10). An insider-outsider researcher status gave me both opportunities and challenges in conducting fieldwork. My background and keen familiarity with the Indonesian tax system contributed to ease in recruiting and developing rapport with participants – an advantage I did not have in my Australian case study. In other words, this insider role status granted me 'more rapid and more complete acceptance' (Dwyer & Buckle 2009, p. 58) by my Indonesian respondents.

In Australia, an Australian Leadership Awards scholarship offered by the Australian Government allowed me to work as an intern within the ATO for one week in April, 2011. This internship helped me to develop relationships with ATO officials. To further

build relationships with potential Australian informants outside the ATO, in April 2012 I attended an international conference on tax administration, introduced myself and my research, and followed up with email and phone contact afterwards. I also made contact with consultancy firms, especially accounting and tax consultants and advisers, which advertised themselves as ‘advisers to high wealth individuals’ on their websites.

### *Selecting the sample*

Within the tax authorities of both Australia and Indonesia, I recruited participants from that group of tax officials who held a strategic position in the HWI units or whose positions involved understanding the management of taxpayers’ compliance. In recruiting informants from the ATO, I benefited from ‘insiders’ (King & Horrocks 2010, p. 31) who provided me with lists of relevant officials and their positions. I made direct contact with the officials I thought had a systematic relation to the topic of my study. Some of my participants had been in the Australian or Indonesian HWI units since their inception.

Stakeholders from outside the tax authorities were selected because of their knowledge of HWIs and their taxation and/or influence in the adoption and running of the HWI units. The criteria used for selection of participants outside the tax authorities were: (a) taxpayers who are included in the HWI program; (b) individuals who provided advice to the HWIs or represented HWIs when dealing with the tax authority; (c) representatives

of peak industry and professional bodies<sup>32</sup>; and (d) academics. Details of the interviews conducted in this study are given in the following section.

Unfortunately, in Australia, efforts to obtain respondents who fitted the ‘stakeholders other than tax office’ category failed. The Indonesian focus of the study made it difficult to attract such respondents. This shortcoming was ameliorated to some extent by the amount of quality information that could be freely accessed through the public domain in Australia.

Table 3.1 presents a breakdown of participants interviewed in Australia and Indonesia. The ‘tax official’ group in Table 3.1 includes people who had retired from the tax authority and lacked an association with another institution, or held other positions in the MoF. This kind of respondent is identified as a ‘former tax official’ when quoted in subsequent data chapters.

Participants who were tax officials were in middle and senior positions, both operational and strategic. All had more than 15 years of experience as tax officials. In the Australian case, all respondents from the tax official group in Table 3.1 were still active in the ATO.

In Indonesia, one of the 20 participants in the tax official group had retired a few months before the interview was conducted. Three other participants had left their positions in the DGT, taking up new positions in the MoF (of which the DGT was a

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<sup>32</sup> For Australia, these bodies were the Taxation Institute of Australia and the Institute of Chartered Accountants. For Indonesia, these bodies were the *IKPI* and the Indonesian Taxation Institute and the Indonesian Chamber of Commerce and Industry.

subordinate organisation) or other government agencies. Their quotations are identified as ‘former tax official’.

Respondents who were not tax officials were distributed among six categories in Table 3.1. They could be tax practitioners (tax preparers, lawyers, accountants or consultants), academics, representatives of professional bodies, representatives of international organisations and other organisations (such as government, or an ombudsman’s office), or taxpayers.

**Table 3.1 Categorisation of Participants**

	Tax official	Tax practitioner <sup>1</sup>	Academic	Prof body <sup>2</sup>	Int’l Org <sup>3</sup>	Other Org <sup>4</sup>	Taxpayer	Total
Australia	12	-	1	-	1	-	-	14
Indonesia	20	10	2	4	1	2	3	42
Total	32	10	3	4	2	2	3	56

Note:

<sup>1</sup> Includes professional tax preparers, tax lawyers, accountants, tax advisers, and tax consultants.

<sup>2</sup> Includes tax consultant association, employee association, and chamber of commerce.

<sup>3</sup> Includes IMF and OECD.

<sup>4</sup> Includes house of representative and tax ombudsman’s office

### *Interview process*

I conducted face-to-face interviews with participants whenever possible. Not all participants were available during my field work trips to Indonesia, and not all Australian participants had time in their busy schedules for a face-to-face appointment. These participants were important sources of information because they played key roles in the implementation of HWI tax policy, so different interviewing modes were utilised



to ensure their inclusion in the sample, i.e. face-to-face interviews, telephone interviews, and email interviews (Denscombe 2007).

An argument could be made for both face-to-face and telephone interviewing. While face-to-face interviewing is commonly employed in semi-structured and in-depth interviews, telephone interviews are appropriate for structured interviews (Fontana & Frey 1993), short (Harvey 1988), or to ask for details about very specific situations (Rubin & Rubin 2011). Studies comparing telephone with face-to-face interviews have found that mode of interview does not significantly influence the quality of data (Brustad et al. 2003; Opdenakker 2006; Sturges & Hanrahan 2004). Therefore, the strategy I adopted was to keep the telephone interviews shorter and more targeted, while the face-to-face interviews gave opportunity for more exploratory questioning and discussion.

While almost all participants in Indonesia were interviewed in person, two of the 14 participants in Australia were interviewed by telephone. The telephone interviews were supplemented with information from prior email exchanges with participants.

In some cases, telephone interviews were used for follow-up after an interview, as a supplement to face-to-face interviews, to ask for more comments or for elaborations on a particular issue. Face-to-face interviews followed by a telephone interview are categorised as 'face-to-face and telephone' interviews in Table 3.2.

In one case, a prospective participant who was considered a valuable informant had left Indonesia and was not able to participate in a telephone interview, though he was willing to take part in the study. We communicated via email. Although the quality of

‘interview’ material obtained via email has been questioned (Burns 2010), the context in relation to this participant led to acceptance of this interview as legitimate. Although it is generally believed that face-to-face interviews provide richer data than telephone interviews, and telephone interviews provide richer data than e-mail interviews (Schneider et al. 2002), evaluation of quality should always rest on knowledge of context.

For some participants whom I interviewed face-to-face, follow-up questions were sent through e-mail to clarify, to obtain additional data, to fill in gaps from the previous face-to-face interview, or to ask additional questions that emerged after I had read the interview transcript. I categorise this kind of interview as ‘face-to-face and e-mail’.

In total 54 interviews were conducted in Australia and Indonesia, of which 14 interviews were conducted in Australia and 40 were in Indonesia.<sup>33</sup> This difference in number of respondents between the two cases was not regarded as a threat to the quality of the study. The difficulty in recruiting respondents in Australia (as mentioned above) was offset by the richness of the available secondary data compared to that for Indonesia. In other words, the lack of available official documentation in Indonesia had to be compensated for through recruitment of more respondents who could discuss the HWI initiative.

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<sup>33</sup> One respondent in the Indonesia group did not reside in Indonesia and was interviewed by email. The respondent was categorised in the Indonesia group based on a strong relationship to the topic.

**Table 3.2 Summary of Interview Modes**

<b>Modes</b>	<b>Australia</b>	<b>Indonesia</b>	<b>Total</b>
Face-to-face	9	38	47
Telephone	2	-	2
E-mail	-	1	1
Face-to-face and telephone	2	-	2
Face-to-face and e-mail	1	1	2
<b>Total</b>	<b>14</b>	<b>40</b>	<b>54</b>

All interviews in Australia were conducted one-on-one, while in Indonesia three ‘elite’ interviewees (Rubin & Rubin 2011, p. 179) were accompanied by their staff, and on some occasions, accompanied staff gave their opinions. It is not uncommon, according to Rubin and Rubin (2011), for elites to ask to have their subordinates present during interviews. In such cases, accompanied staff counted as an interview participant only if they offered their own opinions on the matters under discussion (two ‘accompanied staff’ were counted as participants).

I conducted the first interview in Australia on 22 September 2011 through telephone. The last interview conducted in Australia was on 30 May 2012. In Indonesia, the first interview was conducted on 3 January 2012 and the last interview was 19 April 2013. The interviews lasted an average of 50 minutes, with the longest interview lasting one hour and 20 minutes, and the shortest 14 minutes.

All participants were asked for permission to record their interviews. All interviews in Australia were recorded, while 28 of 39 interviews in Indonesia (excluding the sole e-mail interview) were recorded. When interviews were not recorded, I took short notes during them to help recall important information and useful quotations.

While almost all interviews were conducted in the interviewees' places of work, five interviews (three in Australia and two in Indonesia) were conducted in other locations (coffee shop, restaurant, library, or tax court). Interviewees chose the interview locations. Table 3.3 shows some information about the interviews conducted in both countries.

In this thesis the terms *interviewee*, *respondent*, *informant* and *participant* are used interchangeably without any particular consideration for different meanings. For a further discussion of the differences of those terms in the research context to reflect a researcher's view of her or his relationship with the people being interviewed, see Seidman (2006, p. 14).

**Table 3.3 Summary of Interviews in Australia and Indonesia**

	<b>Australia</b>	<b>Indonesia</b>	<b>Total</b>
Number of interviews	14	40	54
Number of participants	14	42	56
Gender of participants			
Female	1 (7.14%)	3 (7.14%)	4
Male	13 (92.86%)	39 (92.86%)	52
Place of interview			
Participants' work place <sup>1</sup>	11	38	48
Other places <sup>2</sup>	3	2	5

Notes:

<sup>1</sup> Includes telephone and e-mail interviews.

<sup>2</sup> Places such as coffee shop, restaurant, library, and tax court.

### *Linguistic considerations*

Interviews conducted in Indonesia, my home country, were in *Bahasa Indonesia*. The internet interview with a former IGO's official working for DGT living outside Indonesia was conducted in English, even though this respondent was included in the Indonesian sample group in the previous tables. When direct quotations from interviews conducted in *Bahasa* are given in this thesis, they are translated into English.

In Australia all interviews were conducted in English. As English is not my first language, taping interviews and later transcribing them was particularly important for understanding the content of the Australian interviews. It is openly acknowledged that at times the meaning of phrases lost some of their nuance due to my non-native ears. On the positive side, I and those I interviewed talked in the same 'taxation language'. No taxation concepts were raised that were problematic for me or my interviewees.

I transcribed taped interviews and translated of selected quotations from the Indonesian interviews into English.

### *The semi-structured interview schedule*

Interviewing was intended to capture private reflections and understandings of events. Therefore, I chose an in-depth and semi-structured mode of interview to permit participants to reconstruct their experiences of the topic discussed and to allow me to explore participants' thoughts, feeling and reasoning (Denscombe 2007, p. 111) without worrying about following a strict questionnaire.

The interview questions varied from one respondent to another but were based on two broad themes: establishing interviewees' understanding of the HWI policy and seeking interviewees' views and analysis of aspects of it (i.e., its appropriateness, its potentials, the positives and the negatives in implementation, supportive and unsupportive elements, and challenges and opportunities). Apart from these two broad themes, questions were asked to develop rapport with participants, depending on the situation. For instance, at the beginning of the conversation I asked how many years they had been in the HWI unit (for tax officials) or assisting HWIs (for tax practitioners) when dealing with the Tax Office, or I shared my experience as tax official in Indonesia. Questions also varied from one participant to another depending on their positions and roles, particularly those from the tax officials group of participants. Table 3.4 contains a list of questions that I prepared as guidance for interviewing participants.

**Table 3.4 Questions Used to Guide for Interviews**

Objective	Questions	Respondent group
Developing rapport	Can you describe your working experience? Specifically in relation to the HWI unit or HWI taxpayers?	All groups
Information of HWI unit	<p><b><u>The background story of the establishment of HWI unit</u></b></p> <p>Can you give me a background story that led to the idea of the establishment of the HWI unit?</p> <p><b><u>The objective of the HWI unit</u></b></p> <ol style="list-style-type: none"> <li>1. As far as you understand, what were the purposes and priority that the Government wanted to achieve through the establishment of the HWI unit?</li> <li>2. In your view, why did the Government choose to prioritise that (based on interviewee’s answer no. 1)?</li> </ol> <p><b><u>Mechanisms used to achieve its objective</u></b></p> <ol style="list-style-type: none"> <li>1. Could you explain how the Tax Office achieves objectives set for the HWI unit?</li> <li>2. Could you show me any specific measures set up following the establishment of the HWI unit (e.g., information system, laws and regulation, or structural changes within the Tax Office) to facilitate achievement of the objectives?</li> </ol> <p><b><u>Actors involved</u></b></p> <ol style="list-style-type: none"> <li>1. In your opinion, who initiated the idea to establish the HWI unit in the Tax Office?</li> <li>2. Apart from that initiator or designer of the policy (if any), who else was involved in the process of setting the HWI unit (it may also include actors from outside the Tax Office) who gave assistance.</li> </ol> <p><b><u>Challenges</u></b></p> <ol style="list-style-type: none"> <li>1. What challenges does the Tax Office face when dealing with HWI taxpayers?</li> <li>2. In general what challenges does the Tax Office face in dealing with taxpayers? How does the Tax Office deal with those challenges?</li> </ol>	Tax officials group – strategic level

Objective	Questions	Respondent group
Implementation of HWI unit	<p><b><u>Actors' understanding of the policy</u></b></p> <ol style="list-style-type: none"> <li>1. Based on your understanding, what are the objectives of the HWI unit?</li> <li>2. Were there any specific efforts made by head-quarter to share knowledge about the HWI unit (e.g., its background, objectives, measures used)? *</li> <li>3. What in your opinion in terms of supports was provided by headquarters to implement this unit? *</li> </ol>	<p>Tax official group – operational level</p> <p>* Specifically for Indonesian respondents</p>
Perception about policy	<p><b><u>Stakeholders' views on the policy</u></b></p> <ol style="list-style-type: none"> <li>1. What is your opinion in relation to the decision by the Government (Tax Office) to establish an HWI unit?</li> <li>2. What challenges does the Tax Office face in managing tax compliance of taxpayers in general and HWI taxpayers in particular?</li> <li>3. What in your opinion are the supports that were offered and should have been offered in relation to the operation of the HWI unit?</li> <li>4. How were your experiences when dealing with the HWI unit? †</li> </ol>	<p>Participants other than tax officials group</p> <p>† Specifically for HWI taxpayers or their advisers</p>

As mentioned in section 3.3.1, I also utilised a recording of an interview with senior official in the MoF and DGT in relation to bureaucratic reform and tax administration reform in Indonesia.

### 3.3.3 Data analysis

Interview material gathered during the research were coded manually (that is, classifying themes emerged from data using single descriptive words or short phrases (e.g., Saldana 2009)). Manual coding was performed using word-processing software. More powerful qualitative coding software such as NVivo or ATLAS.ti was unnecessary given that there was little reason to believe that the frequency of codes or themes would shed light on the questions being asked. One comment from a well-positioned and insightful person might prove far more relevant for understanding the



fate of the HWI unit in Indonesia than the more common-place answers given by the majority of tax officials within DGT. Themes were evaluated in terms of their theoretical importance rather than the frequency of occurrence. The materials coded included 42 taped interview transcripts, 13 sets of interview notes, one email conversation and analytic memos.

Analysed data that emerged from the above material was triangulated with data from other sources to test their consistency. Links were made from commentators and policymakers between one theme and another, or as guidance to search for more information and gather more material. These other sources included annual reports, policy documents, Hansard records of parliamentary inquiries, and newspaper and magazine articles.

Following Liamputtong and Ezzy's (2005) recommendation, I began the manual coding procedure by formatting pages of data into three columns (see also Saldana 2009, p. 17). The first column contained the data from the interview transcripts, field notes, or documentation. The second column contained preliminary coding notes and jottings. The third column contained the lists of the final codes. Once codes were derived for the data, I analysed the qualitative data using the codes to identify key events, points of agreement and conflict.

### **3.4 Ethics, confidentiality and conflicts of interest**

The Australian National University (ANU) Human Research Ethics Committee gave ethical approval for this research. It is important to note that this research did not involve any individual taxpayer data. Rather, it was aimed at understanding the collective learning of the HWI tax officers who have worked with HWI cases, and with

insights from stakeholders about policy and governance arrangements, not individual taxpayer cases. Interviews proceeded only after voluntary informed consent was obtained, either verbally when I explained the nature of the research and their rights to potential participants or, in only 3 cases, provided participants with a standard consent form.<sup>34</sup>

In accordance with my promise to participants to maintain their anonymity, participants' identities (their names or positions in the organisations, and organisations' names other than ATO and DGT) are not disclosed. When direct quotations from participants are given in this thesis, a code of RA or RI followed by a three-digit number and an identifier of respondent group are used. Code RA is used for respondents interviewed in Australia and RI is for respondents interviewed in Indonesia (including one respondent who resides elsewhere and was interviewed through email). Although efforts were made to disguise the identities of the participants, some insiders might be able to identify certain individuals by connecting their quotations with the context of the time, position and events. This is most likely with respect to the few interviewees holding high-level positions within the MoF and DGT. Every effort was made to minimise this possibility through careful presentation of data.

Ethical issues became pronounced due to my insider-outsider status, which granted me a 'more complete acceptance' (Dwyer & Buckle 2009, p. 58) by my Indonesian respondents than might otherwise have been possible. In this respect, respondents were more open in expressing their opinions, thoughts, and experiences related to the

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<sup>34</sup> Participants who chose not to sign the consent form told me that 'it was just a formality' and that 'I would not have interviewed them if they did not consent'.

problems that arose during the formation of the HWI units in particular and Indonesian's tax administration in general. A similar ethical situation was faced by Talbot (1998) in conducting research on the very sensitive topic of mothers who experienced the death of an only child: her respondents said that '... they would never have shared certain aspects of their experience if [she] had not been a bereaved mother too' (p. 172). Some of my DGT respondents too said that they would not have told certain stories if I were not a DGT official. Some of the stories they told me were labelled 'off the record'. If interviewees asked me to keep some parts of the conversations off the record, I did not use this information in any quotations, although I did use the insights to enrich my understanding and to guide me to find any publicly available related information.

Although my insider status in the Indonesian case study conferred advantages in recruiting participants, it was potentially an impediment to the data collection. Dwyer and Buckle (2009, p. 58) pointed out two possible problems that may occur due to insider status. First, participants can provide incomplete explanations of their individual experience as they presume the researcher has similar experience, knowledge, or thoughts. I occasionally recorded sentences such as 'I think you understand well what I mean', 'I guess I don't need to explain to you in detail about this', or unfinished sentences in interviews both in Indonesia and Australia. Secondly, the researcher's experience can colour her/his perception about the subject under study, resulting in an interview that is influenced by the core aspects of the researcher's experience and not

the respondent's.<sup>35</sup> In other words my insider status in Indonesia might bring me to a conflict of interest position.

In order to overcome these methodological challenges, I made efforts to neutralise the conflicting duality of my insider-outsider status in the following ways. First, when respondents started to pull me into their 'identity group' (Kanuha 2000, p. 439), I tried to distance myself from the subject under discussion by 'pushing' my respondents a little bit further to elaborate upon any coded responses that they presumed I had already understood or should have known. For instance, instead of providing me with detailed information with regard to 'disharmonised' relationships between DGT and other agencies in relation to data-sharing processes, my Indonesian respondents would prefer to say 'I think you already understand. Coordination [between governmental agencies] is a "luxurious commodity" here in Indonesia'. Although I understood what she/he meant, instead of giving the informant a signal of confirmation, I would follow the comment up with a question, such as 'Why has coordination between agencies become a luxurious commodity?' or 'Could you give me examples about this to elaborate more about what you mean?' By doing this, I not only distanced myself from situations with which I was familiar, but I was also able to pursue deeper insights from the respondents and put to one side any preconceptions I may have had.

Second, in order to maintain my impartiality and objectivity in this research, particularly with regard to the Indonesian case study and my status as a member of the organisation under study, I made special efforts during the research to be aware of my

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<sup>35</sup> Nevertheless, Srinivas (1996), as cited by Aguilar (1981, p. 26), pointed out that bias that might come from a researcher's insider status might very well be a source of insight as well as error.

personal judgments or perspectives and avoid incorporating them into this research. Giving seminars and talking to others about my research in Australia, where I was based for my PhD, helped give me a sense of perspective on where a line was to be drawn between my personal views and experiences and the systematic and impartial collection of data about the HWI unit. Every effort was made to ensure that the findings of this research were ‘a function solely of the informants and conditions of the research and not of other biases, motivations, and perspectives’ (Guba 1981 cited in Krefting 1991, p. 216).

## **Summary**

In examining the implementation stage of a policy transferred from one jurisdiction to another, it is important to obtain information not only from documents about the policy event but also from stakeholders who were directly or indirectly involved or affected by the policy. This enables development of an understanding of what actually happened as well as what was expected to happen. The focus of this study, therefore, was on Indonesia’s practices in implementing a transferred policy. Because of this focus, the interview data from Indonesia was richer and more complete than that from Australia. Australian tax officials were generous with their time and information, but other Australian stakeholders declined to discuss how Australia’s HWI unit was set up and operated. My outsider status with respect to the Australian taxation community (e.g., tax advisers, consultants, accountants and taxpayers) might have contributed to this situation, given the nature of the topic to be discussed with a foreigner like myself. Fortunately, secondary data, particularly from others’ research on the same area and publicly available institutional documents, helped cover shortcomings from this side. In

contrast, access to interviewees was relatively easy in Indonesia and this compensated for shortcomings in government agencies' documentation.

In order to gain insight from actors involved in the implementation of HWI units in Australia and Indonesia, I conducted 54 interviews involving 56 participants (14 in Australia, 42 in Indonesia). Fourteen interviews were conducted in Australia with middle- and senior-level officials at the ATO, a representative of an international organisation, and an academic. Some of the participants from the ATO had been involved in the HWI unit since its inception.

In Indonesia, 40 interviews were conducted with a greater variety of participants. Participants from the tax official group came from the highest level at the DGT (2 echelon I), the mid-level (6 echelon II and 5 echelon III) and the lowest level (6 section heads, echelon IV), included one tax auditor. They represented actors in both strategic and operational positions. As the HWI unit in Indonesia was relatively new when the study was conducted, all but one participant from the HWI unit were involved in the unit since its inception. A participant from an international organisation who assisted DGT in setting up the HWI unit participated in the interview through an email interview. Interviews were also conducted in Indonesia with stakeholders outside the tax office, particularly with those who were directly involved with or affected by the works of the HWI unit (e.g., taxpayers, tax practitioners, and taxpayer's representative). To gain insight from those indirectly affected by the HWI unit's work, I conducted interviews with actors who represented academia, the tax ombudsman, and business associations about the work of the DGT in general and the HWI unit in particular.

The documentation gathered and analysed in this research was publicly available or obtained through special request. Sources of documentation included tax authorities, other government agencies, NGOs, the mass media, and published research. This research does not include any individual taxpayer data. Data from tax authorities (the ATO and DGT) appears in aggregated form. In the Indonesian case study, when documentation was not publicly available, a special request was submitted. While some requests were granted, others were not successful, mainly due to confidentiality concerns.

In the next chapter I discuss the development and implementation of the HWI policy in Australia; this includes my analysis of primary and secondary data relating to Australia's HWI Taskforce, with particular focus on answering questions as how the policy is practiced in this country. The chapter provides valuable background when reflecting on how the HWI unit in Indonesia was set up, and acts as a benchmark for evaluating the Indonesian HWI unit's services.





# Chapter 4

## The High Wealth Individual Initiative: An Australian Approach

*...let me again pose some questions for you. Have you found or heard of any other tax administration that has so openly established a specific focus and task force in the area of high wealth individuals? Have you found any other tax administration that has so professionally and determinedly pursued those activities in the face of sometimes hostile criticism?*

(Michael Carmody, former ATO Commissioner, in front of Senate Economics References Committee, 9 February 2000)

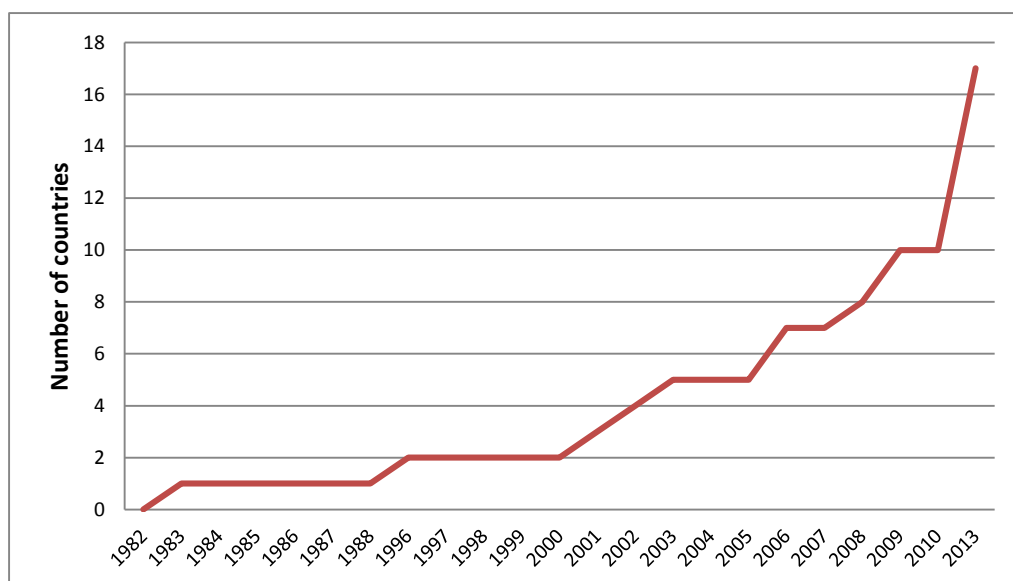
### Introduction

This chapter depicts how the Australian model of managing the tax compliance of very wealthy taxpayers was developed. Australia was an important source of information and advice for setting up an HWI unit in Indonesia's DGT, as described previously. Australia also provided rich documentation on developing a policy with sensitivity to the context in which the policy is required to work. This chapter illustrates the degree to which Australia's HWI unit was embedded in policy development within the ATO and

the process of organisational and administrative change, and was consistently supported at the highest level of government.

### *The HWI unit in Australia: its beginnings and influence*

Establishing a dedicated unit within a tax administration to monitor the tax compliance of very wealthy taxpayers is not a new practice. In 1983 – more than a decade before the ATO set up its HWI unit in May 1996 – France’s tax authority had come up with the idea of creating a unit within its tax administration that was aimed at strengthening tax compliance and enforcement efforts directed towards its HWIs. However, this regulatory model did not gain popularity internationally until the 1990s, at which time the ATO formed its HWI taskforce and introduced a new approach to monitoring the tax compliance of HWIs and their entities (see Figure 4.1).



**Figure 4.1 Number of countries with HWI units**

Source: OECD (2009a; 2013b)

The approach to tax administration introduced by the ATO in 1996 had never before been applied and was considered a ‘regulatory innovation’ (Black, Lodge & Thatcher 2005; see also Hong & Braithwaite 2011, p. 6). It was innovative in that it used ‘new solutions to address old problems’ (Black 2005, p. 4). Tax avoidance and evasion are not new problems for tax authorities around the world, but strategies for minimising tax have developed in sophistication to the point that tax authorities must find new solutions to manage them (Gravelle 2010). The institutional arrangements and compliance monitoring approach pioneered by the ATO attracted international interest in the early 2000s (see Figure 4.1). Even the US tax authority (Internal Revenue Service – IRS) was interested in learning from the ATO (U.S. Government Accountability Office 2011).

Like [the] ATO, the IRS is taking a close look at high-income and high-wealth individuals and their related entities. In 2009, [the] IRS formed the Global High Wealth Industry (GHWI) program to take a holistic approach to high wealth individuals. IRS *consulted with the ATO to discuss ATO’s approach to the high-wealth population as well as its operational best practices.* (U.S. Government Accountability Office 2011, p. 46, my emphasis)

Figure 4.1 illustrates the increased popularity of the HWI regulatory model among tax administrations, particularly since 2008, from two national tax authorities in the 2000s, to at least 17 tax administrations with some kind of institutional arrangement that focuses on HWIs as a taxpaying group. Undoubtedly the increased population of HWIs around the globe, advancements in communication and information technology, and the increased degree of freedom of both human and capital movement HWIs have prompted increased activity by tax authorities to meet the challenges of collecting tax from this group of taxpayers.

Transferring a tax policy from other jurisdictions is not as simple as importing a machine that will be installed in a plant in another country. A policy does not live in a vacuum. It must relate coherently to existing policies to work effectively and sit harmoniously within the socio-political environment in which it operates (e.g., Rose 1993). For successful implementation a policy requires support from other elements, which may include policies in other fields, organisational structure, laws and regulation, politicians, government, industry and other institutions, and more importantly the cultural aspects within which actors and institutions implementing the policy are embedded (Hogwood & Gunn 1984).

A policy is developed in a polity with certain underlying objectives, which may change the policy when the objectives are altered. Transferring a policy without considering other factors surrounding the policy in its originating setting and without understanding its underlying objectives may lead to what Dolowitz and Marsh (2000, p. 17) termed ‘incomplete transfer’; that is, a kind of policy transfer in which ‘crucial elements of what made the policy or institutional structure a success in the transferring country may not be transferred’ (p. 17). This is likely to lead to policy failure.

Dolowitz (2000b) provided an example of this kind of policy failure from the 1990s, when the Thatcher government introduced the UK’s Child Support Agency (CSA), a policy transferred from the American Child Support Enforcement System (CSES).

The CSA did not work as the UK’s government originally hoped because insufficient attention was given to the context into which the policy was to be implemented. Politics and ideology played important role in how the CSA policy was implemented in the UK. The failure CSA in the UK was in part down to the ideological leanings of the Thatcher

government, who framed single parent families as a social scourge that threatened the fabric of society. This ideological base had driven policy objective into different direction differed from that in its original country.

The above example gives insights into the issues that are of central importance in considering policy transfer in relation to collecting tax from HWIs. Attention needs to be given to understanding the policy's underlying objectives, the measures employed to achieve the objectives, and what elements support the policy in its originating setting (e.g., institutional arrangements). The HWI Taskforce in Australia is supported by many other policies, institutional arrangements, regulation and organisational structures that make it possible to operate in such a way that it has been regarded internationally as a best practice model of how to improve the tax compliance of HWIs (Senate Economics References Committee 2000).

The HWI Taskforce was not established merely to increase government revenue from this taxpayer segment (an objective that, as discussed in Chapter 5, became the Indonesian tax system's primary orientation). Rather, it was formed to improve the ATO's understanding of wealthy taxpayers, identify their tax planning techniques, and develop administrative and legislative proposals to address undesirable tax minimisation practices (The Auditor General 2000). Of course, achievement of the targeted revenue also became part of the set of goals associated with the policy. Increased revenue collection was a commitment made by the ATO to justify the government's investment in its special HWI unit.

Other institutional initiatives that supported the way in which the ATO's HWI Taskforce operated were the ATO compliance model and the *Taxpayers' Charter*. The

compliance model changed the ATO's operational practices, not only in relation to taxpayers but its staff (Hobson 2003). The *Charter*, on the other hand, played a role in eliciting cooperation and containing resistance once a partnership between the tax authority and taxpayer had been established (V. Braithwaite 2005).

This chapter consists of three parts. The first part elaborates the ATO compliance model and the *Taxpayers' Charter* which have been used to guide compliance management in the ATO since 1997. A fundamental change that the compliance model introduced was, first, that the enforcement measures that the ATO applied in securing compliance from taxpayers should include a greater variety of strategies. It begins with learning, educating, and persuading, and only when these fail, it escalates pressure up a regulatory pyramid, first with warnings then sanctions of increasing severity with prosecution or some other severe sanction at the top of a 'regulatory pyramid' (Braithwaite & Braithwaite 2001, p. 412). Second, the Model and the *Charter* took into consideration taxpayers' individual circumstances when dealing with compliance issues. Understanding taxpayers' circumstances gave the ATO the opportunity to use a variety of enforcement strategies with the intention of improving future compliance. The circumstances influencing compliance were captured by the acronym BISEP, representing business, industry, sociological, economic and psychological drivers of compliant and non-compliant behaviours.<sup>36</sup>

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<sup>36</sup> BISEP represented the idea that for understanding the compliance of an individual or group and for acting proportionately based on that understanding, the tax authority and its official needed to understand the taxpayer's individual circumstances (Hobson 2003, p. 154). For details about what is included in each category, see Appendix C. In the context of large corporate taxpayers, a sixth factor called S = System of compliance is added.

With respect to internal relationships among tax officials, the compliance model was ‘a new way of talking and communicating’ (Hobson 2003, p. 139). Sharing best practices, sharing stories in meetings, and increased discussion among staff about cases they found in the field were examples of improved inter-staff communication after the introduction of the model (Job & Honaker 2003, p. 117). By improving staff communication, the compliance model improved inter-staff relationships. Good inter-staff relationships are a crucial element when an organisation introduces a new policy, such as the HWI initiative in Indonesia, partly because good inter-staff relationships will facilitate the flow of policy knowledge and feedback on policy implementation (Cawsey 2012).

The second part of this chapter describes a regulatory initiative to manage tax compliance of the wealthy taxpayers group in Australia, the HWI Taskforce. I discuss the historical background for the establishment of the Taskforce to expose the basic reasoning behind its introduction and to demonstrate the kinds of support underpinning its development. Understanding the social and political situation before and during the formation of the Taskforce gives a sense as why certain principles were embraced to determine Taskforce objectives; the mechanisms employed to achieve those objectives; and the relationships that were built among actors who were involved with or were affected by the policy. These are discussed in the third part of this chapter, along with a discussion about how the ATO compliance model and the *Taxpayers’ Charter* were embedded in the HWI Taskforce operation, providing a cultural base from which the HWI initiative grew, guided by principles, and actioned through mechanisms supported by powerful actors.

#### **4.1 The introduction of the ATO compliance model and the *Taxpayers' Charter*<sup>37</sup>**

The introduction of a responsive regulatory enforcement approach in the ATO occurred during the 1990s at a time when the organisation was facing constant media and public scrutiny due to perceptions that it had excessive power and used it unfairly (Gumley & Wyatt 1996; Job & Honaker 2003). There were claims that the ATO was 'out of touch' and 'lacked understanding' of 'commercial reality' ('The critics' 1997, p. 193) and that poor use of penalties 'threatened the integrity of the tax system' (Chamberlin 1996). Such criticism brought demands for change, not only from the community but from the national government.

Facing media and public scrutiny, along with political demands for greater accountability, the ATO adopted several measures intended to make it more accountable, open and responsive to taxpayers (Murphy 2004a). Under the influence of the New Public Management perspective (Hood 1991), nomenclature changed, as did the priority given to on-going cooperative relationships. All branches of public administration were required to change their thinking in relation to the community: They became 'clients' and 'customers', a way of thinking that challenged traditional conceptions of the 'forever reluctant' taxpayer.

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<sup>37</sup> A detailed discussion about the ATO compliance model and the Taxpayers' Charter in this section is to provide a description that ATO's effort in managing tax compliance of HWI taxpayers was not a sole initiative. It was supported by other initiatives including—perhaps more importantly—the way the ATO and its staff treated taxpayers. This integral part of managing tax compliance, as we will see later, was not taken into consideration in the Indonesian context when it adopted the HWI policy. Actors sent to learn from the HWI unit in Australia were not aware of the existence of other supporting elements such as the ATO compliance model that implements a responsive regulatory approach to taxpayers and uses the Taxpayers' Charter. In the thesis limitations, I acknowledge that the interviews about the effectiveness of the Charter and compliance model were restricted to the ATO preventing a more critical analysis. This was, however, tangential to the purpose of this thesis.



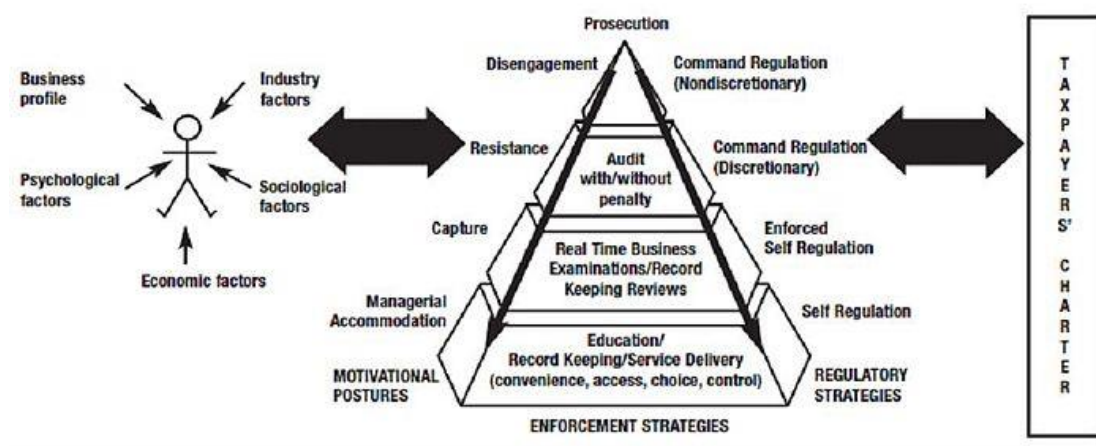
The introduction of the *Taxpayers' Charter* was one of the measures that the ATO adopted in response to these developments. Formally launched in July 1997, the *Charter* was designed to improve the relationship between the taxpaying community and the ATO and to help reinforce the community's confidence in the ATO's operations (ATO 1998b). More importantly, the introduction of the *Taxpayers' Charter* indicated an initial step away from the long-established style of command-and-control enforcement toward a more progressive style, represented ultimately through the adoption of a responsive regulatory enforcement model (Hobson 2004; Job & Honaker 2003; Murphy 2004a; Shover et al. 2003).

The responsive regulatory enforcement model was the ATO's compliance model. In Australia the responsive regulatory model has been applied by numerous regulatory agencies both at the federal and states levels (Wood et al. 2010). The ATO is one of the regulatory agencies that adopted the idea of 'responsive regulation' in its compliance activities. The idea of responsive regulation and the ATO compliance model was first introduced in the Cash Economy Task Force report (Cash Economy Task Force 1998). The model was introduced 'to complement principles underlying the *Taxpayers' Charter*' (ATO 1998a) and 'to bring the *Taxpayers' Charter* into life' (RA009, academic). The model required the ATO 'to foster a more cooperative and participative regulatory regime and to become more open [or transparent] and accountable in its enforcement activities' (Cash Economy Task Force 1998, n.p.). Transparency and accountability in enforcement by regulatory agencies has long been an issue in other countries and in other regulatory arenas.

The ATO Commissioner at that time, Michael Carmody, in his comments on the introduction of the model, stated that the model was based on two premises (ATO 1998a):

One is that the ‘one size fits all’ solutions are no longer appropriate. Different approaches are required to support and acknowledge those trying to do the right thing, while targeting our toughest approaches to the hardened evaders. Secondly we will work closely with different industries to develop joint approaches to improving compliance and providing a level playing field for legitimate business.

The ATO’s approach to compliance was therefore twofold (Wood et al. 2010, pp. 13–14). First, it sought to maximise the number of taxpayers who chose to comply voluntarily. In order to achieve this goal the ATO had to help taxpayers to meet their tax obligations and understand their rights and entitlements as easily as possible. Second, the model aimed to deter, detect and address any non-compliance practices, with the emphasis on understanding the reasons behind non-compliance in different industry groups, and developing appropriate and proportionate responses to non-compliant individuals and entities on the basis of this understanding.



**Figure 4.2 ATO Compliance Model**

Source: Cash Economy Task Force (1998, p. 58)

Figure 4.2 presents the ATO compliance model in diagrammatic form. As illustrated in Figure 4.2, the model also incorporates external factors that might play a role in influencing a taxpayer's compliant and non-compliant behaviour. The factors are grouped into the five BISEP categories. A better understanding of the various external factors and how they influence taxpayer behaviour was intended to assist the ATO to develop ways to encourage the motivation to do the right thing and, at the same time, to limit the motivation to be non-compliant (Cash Economy Task Force 1998, p. 23).

The ATO compliance model incorporates the concept of motivational postures to remind tax officials of this positioning and the importance of cultivating the most positive social relationship they can build with taxpayers (Braithwaite 1995; Braithwaite et al. 1994). Posturing to authority is pictured on the left side of the pyramid in Figure 4.2. Motivational postures reflect how people orient themselves to engage with the regulatory system (Braithwaite & Braithwaite 2001, p. 410). Taxpayers use postures to signal the social distance they wish to maintain between themselves and authority. Social distance reflects the degree of liking and willingness to defer to authority. Postures determine the influence processes that are likely to be required to change non-compliant practices (Braithwaite 2009, p. 89). The four motivational postures arranged on the left side of the pyramid from bottom to top reflect openness to influence by the Tax Office, namely: the postures of *accommodation* and *capture*, compliant postures that are receptive to education and supervisory interventions to improve their compliance; the posture of *resistance*, a confrontational stance to the tax system as well as to tax officers, but which is open to debate and persuasion over compliance, perhaps closer scrutiny as long as this occurs respectfully; and the posture

of *disengagement*, the most socially distant posture (both dislike for taxation and refusal to defer to the tax office) and which requires more coercive measures to elicit compliance.

The elements shown on the centre face and on the right side of the pyramid in Figure 4.2 group the enforcement and regulatory strategies the ATO intended to use to elicit compliance among those operating in the cash economy. Enforcement strategies featured in the centre panel of the pyramid represented incremental enforcement actions to signal to the taxpayer that the ATO would escalate enforcement if the taxpayer was not prepared to adopt a cooperative posture (Braithwaite 2009, p. 88). There are two basic premises of this enforcement strategy: first, it is assumed that most of the taxpayer population is located at the base of the pyramid. In the case of Australia and some developed countries like the US or the UK, evidence shows that this assumption is accurate (J. Braithwaite 2003a, p. 179). However, this has been called into question by the research of Elea Wurth (2012). Second, the ATO has capacity and readiness to follow through on non-compliance (Ayres & Braithwaite 1992; V. Braithwaite 2003a, p.5). Given these assumptions, the broadest coverage of enforcement strategies is aimed at encouraging voluntary compliance through approaches like education and convenient and efficient service delivery which helps taxpayers meet their obligations with least effort and cost. The approach of the ATO to non-compliance is more targeted, moving to a higher level of enforcement activity with those taxpayers who fail to comply in response to broader appeals for public cooperation. Strategies of visiting businesses and checking records increase the level of intrusiveness and oversight. For those who still do not comply, follow-up enforcement action will be more intrusive with audits, for

example. These measures, if unsuccessful, can be followed up with highly intrusive measures such as prosecution (Braithwaite & Braithwaite 2001).

On the right side of the pyramid are broader categories of regulatory responsiveness, the progression from bottom to top reflecting increasing levels of regulatory intrusiveness. At the base of the pyramid, the approach of the ATO is self-regulatory. In other words, taxpayers are informed and given responsibility to manage their tax compliance voluntarily. Under self-regulation, they are trusted to do so. The tax authority's role at this level is providing taxpayers with the means of 'doing the right thing' with ease (e.g., education, accessible information, choices, service deliveries). Self-regulation relies on and generates cooperative relationships in the taxpayer community. Going up the pyramid, the style of engagement becomes more punitive and command-and-control, with less opportunity for tax officers to use discretion in how they deal with non-compliance. Although coercion is present as an option in Figure 4.2, threats of severe sanction are kept in the background in compliance model thinking. The existence of these punitive sanctions and taxpayers' knowledge about the capacity of the ATO to get as tough as needed are known in the population and if left in the background, will encourage more voluntary regulation (Cash Economy Task Force 1998, p. 25). When a command regulatory style has been used and elicited compliance, there is no reason for not placing trust in the taxpayer to comply voluntarily. Taxpayers should be allowed to self-regulate or operate under an enforced self-regulatory model (with some checks in place to make non-compliance readily detectable). Under the ATO compliance model, taxpayers should not be stigmatised as perpetual tax offenders.

Whatever regulatory strategy and enforcement action is chosen, the model emphasises the importance of abiding at all times by the principles of procedural justice which were

embodied in the *Taxpayers' Charter* (Braithwaite 2009, p. 88), as pictured on the outer right side of the regulatory pyramid. Regulatory enforcement strategies are aimed at enforcing the law through processes that abide by the principles of the *Charter*.

In short, the ATO compliance model offers a full range of enforcement strategies and regulatory actions that the ATO and its officials might choose when dealing with taxpayers. Choice is determined by the particular circumstances of the individual or entity as revealed by the BISEP and by taxpayer willingness to comply. Treating taxpayers in accordance with their individual circumstances is in accord with the *Taxpayers' Charter*. Taxpayers should be trusted to do the right thing, be treated with respect, be informed about the Tax Office's concerns and analysis, and have the opportunity to present their case with a fair and reasonable hearing. These principles of engagement with taxpayers are integrated into the compliance model and the *Taxpayers' Charter*.

The introduction of the ATO compliance model brought about a paradigm shift in the ATO. Understanding taxpayers (Cash Economy Task Force 1998); making compliance easier, cheaper, and more personalised (ATO 2013c); tailoring interventions in response to circumstances (Braithwaite & Braithwaite 2001); and listening to taxpayers before they contest decisions meant that taxation administration had to shift from being isolated from the community with a command-and-control style of operation to being far more dialogic about objectives and principles, how they would be achieved and how coherent the overall compliance strategy was within the ATO.

After being introduced in 1998 for the cash economy and small and medium business enterprises (SMEs), the ATO compliance model was extended and applied to individual

taxpayers, large business and to the HWI Taskforce. Before discussion turns to how the taskforce applied the compliance model to its daily operation, the next section describes the background to the establishment of the HWI Taskforce initially as a special unit in the ATO.

## **4.2 High wealth individual taskforce: background and role overview**

This section describes the political background of the establishment of the HWI Taskforce and its current development.

### **4.2.1 Historical background and political setting**

It has long been a common public belief that along with big corporations, very wealthy individuals do not pay their fair share of taxes. In the US for instance, Hochschild (1981) concluded that ‘almost everyone, rich and poor, is incensed that the very wealthy do not pay their fair share of taxes’ (p. 280). Hochschild’s conclusion remains current. Bartels (2005) found that the majority of his respondents believed that the very rich were asked to pay less than they should (see also McClosky & Zaller 1984 for another study in the US). In Australia the public has also become sensitised to the issue of HWIs not paying their fair share of tax (J. Braithwaite 2003b, p. 245). Along with this commonly held belief, the Australian public also perceived tax authorities as ‘soft on the big end of town while being hard on ordinary taxpayers’ (Senate Economics References Committee 2000, p. 5). In a nation-wide survey, Braithwaite et al. (2001) found that Australians perceived the Tax Office as being more willing to use its power in relation to making small business and wage and salary earners pay their tax than in making large companies and HWIs pay theirs (Braithwaite et al. 2001, p. 7).

The perception of unfairness is connected with the view that it is easier to collect tax from individuals and small businesses in some respects. Dealing with wealthy taxpayers is more challenging because they have complex business and financial structures. Tax officials do not always find it easy to understand the structures through which HWI taxpayers arrange their tax affairs, and even when they do understand them, they can be unsure about their legitimacy. Complexity of tax and business affairs does not necessarily mean tax evasion or avoidance occurs. Tax officials need to be confident in their judgements. Very wealthy taxpayers have access to the brightest financial advisers as well as ‘tax engineers’ who provide them with tax minimisation techniques that are more sophisticated than those tax officials usually encounter.<sup>38</sup>

During 1995-96, the ATO raised concerns about some wealthy individuals’ income tax behaviour. An ATO study of the accumulation of wealth by certain individuals and the taxes they paid revealed that some HWIs sampled in the analysis were ‘employing strategies which allowed them to accumulate wealth, enjoy a lavish lifestyle, but pay little or no tax’ (Joint Committee of Public Account and Audit 2001, p. 74). Furthermore, in its advice to Treasurer Ralph Willis, the ATO’s analysis revealed that:

...in the 1993 financial year, 80 individuals each with a net worth of over \$30 million had returned taxable income of \$20,000 or less ... The tax minimisation techniques employed by these individuals involved the use of trusts. (Joint Committee of Public Account and Audit 2001, p. 74)

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<sup>38</sup> See John Braithwaite’s (2005) book *Markets in Vice, Markets in Virtue* for a study of how aggressive tax planning has been marketed in the U.S. and Australia in which tax advisers, financial planners, accountants and lawyers play a significant role in the industry; and more importantly the study found that aggressive tax planning is not only driven by supply, but also there is a demand side induced by competition.



Another study conducted by the ATO in mid-1990 identified certain tax planning arrangements used by some wealthy individuals to avoid tax. These included such practices as:

- redefining income as capital by the use of multiple trust structures to conceal a common controlling mind;
- creating artificial losses (revenue as well as capital) to neutralise otherwise taxable profits, particularly through the use of related party transactions and acquiring companies or trusts with accumulated losses;
- disguising distributions to HWIs and family members as loans and other benefits which were claimed to be non-taxable;
- using offshore trusts to hold significant funds;
- using charitable trusts and overseas organisations to disguise benefits to HWIs and family members; and
- converting activities undertaken for private pleasure into tax losses (e.g., pleasure craft, horse breeding and racing) (Joint Committee of Public Account and Audit 2001, pp. 74–75; see also J. Braithwaite 2003b, p. 245).

This, however, is not to deny that trusts provide an appropriate structure to meet a range of legitimate needs of charities, educational and non-profit organisations, families, solicitors and other professionals (Joint Committee of Public Account and Audit 2001, p. 75).

John Braithwaite has suggested that it was this kind of evidence that caused the Keating government (Labor party) to use high wealth taxpayers as an election issue in 1995 (J. Braithwaite 2003b, p. 245). In the election campaign, Prime Minister Keating

detailed Labor's funding plans for its election promises, revealing a plan to crack down on massive tax avoidance amongst some of Australia's wealthiest people (Farnsworth 1995).

Eighty individuals, each with a net worth of over \$30 million, [had returned] taxable incomes of \$20,000 or less. And not only that, because of that, they'd avail themselves of the Medicare exemption, of low income rebates and generally ran a policy of exploiting, wilfully, the tax system. (Paul Keating, former Prime Minister, cited in McDonnell 1996)

In a press conference, Prime Minister Keating (accompanied by the Treasurer, Ralph Willis) showed a diagram labelled 'High Rollers' Trust Web', claiming that they would raise \$800 million a year by attacking a tax rort that was claimed as the biggest since 'the bottom of the harbour' scheme of the early 1980s (Farnsworth 1995).<sup>39</sup>

The figure of \$800 million revenue was controversial and became a subject of heated debate (Parliament of Australia 2000). The debate continued and widened in the opposition it attracted as illustrated by the following exchange from ABC radio's *Background Briefing* program 'Hunting Down The Rich 100' (30 June 1996) (McDonnell 1996 see box below).

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<sup>39</sup> The "bottom of the harbour" term was used to refer to complicated methods used for avoiding company tax that were very popular in Australia in the 1970s and 1980s. The methods involved either stripping a company of its assets before tax became payable, or using another company as the entity upon which tax became liable while maintaining that the latter company never had sufficient assets to pay the tax owed. The methods were labelled 'bottom of the harbour' schemes since the records of the stripped companies were, metaphorically, sent to the bottom of Sydney Harbour after they had served their purpose (Popple 1989, p. 259). For a more thorough discussion about tax schemes popular in Australia in the 1970s and 1980s, see Trevor Boucher's book *Blatant, Artificial and Contrived: Tax schemes of the 70s and 80s* (Boucher 2010).

**Stephen McDonell (Reporter):** The tax lawyers have struck back hard, attacking the credibility of the High Wealth Project, the Tax Commissioner, the former Treasurer and the supposed figure of \$800 million in avoided tax.

**Norman Rosenbaum (Tax Barrister):** If that \$800 million is not there at the end of the day and this is just a myth, those people responsible for this myth have to be made accountable.

**Stephen McDonell:** When you speak of those responsible, I suppose you mean the Tax Commissioner, the Treasurer, who?

**Norman Rosenbaum:** I would be going back to Treasurer Willis, the then Treasurer Ralph Willis, who at the time made the announcement.

#### **Box 4.1 Dialogue ABC reporter with a tax barrister**

Source: McDonell (1996).

The Labor Party lost government in the 1996 election and the Coalition (the Liberal and National parties) came to office in a landslide victory. Interestingly, the issue was used by the newly elected Howard government to set up an institutional arrangement within the ATO to find an effective management strategy to enhance compliance for HWI taxpayers. The incoming government claimed that it was their promise to develop an HWI regulatory initiative to improve tax compliance of the wealthy, even though they had opposed Keating's idea (Costello 1996).

Although never explicitly expressed, one of the reasons for the establishment of the HWI unit was to repair the budget, which at that time had an underlying deficit of \$10.3 billion (1995-96 budget year). The estimated underlying deficit for the year 1996-97, when the HWI Taskforce was set up, was \$5.6 billion. For the year 1998-99, the

projected underlying deficit was \$7.2 billion (Commonwealth of Australia 1996). In his Budget Speech, Treasurer Peter Costello offered measures for repairing the budget which could be achieved through expenditure savings, ‘with a contribution from reduced tax expenditures and measures to curb tax avoidance’ (Costello 1996, p. 2). Establishing the HWI unit was a policy implemented by government that was publicly committed to addressing a ‘fiscal crisis’ – a reason that is commonly given when a new tax-related policy is introduced (e.g., Sharman 2010).

The new Coalition government allocated substantial funds for the establishment of the HWI Taskforce, as mentioned in the Treasurer’s Budget Speech 1996-97:

In keeping with our stated position during the election campaign, I announce tonight a major effort to improve tax compliance.

The Australian Taxation Office (ATO) will be provided with additional funds in 1996-97 and 1997-98 to establish *a special high level task force to improve the compliance of high wealth individuals* with our income tax laws.<sup>40</sup>

Enhanced investigation activity and analysis will allow a greater understanding of the complex arrangements used by some high wealth individuals to minimise tax, and to progressively develop administrative and legislative proposals to deal with these arrangements and others that may be put in place in the future. (Costello 1996, p. 7, my emphasis)

In May 1996, the Government allocated additional funds of \$19.2 million (Table 4.1) over two years for the establishment of the HWI Taskforce as ‘the implementation of election commitments’ (Commonwealth of Australia 1996, p. 3).

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<sup>40</sup> ATO defines HWI as ‘an Australian resident who, together with associates, effectively controls \$30 million or more in net wealth’ (Australian Taxation Office 2008, p. 4)

In the 1998-99 Budget, the Government extended funding for the taskforce for a further two years (Table 4.1) until 2000-01. Between the budget year of 2001-02 and 2005-06 the ATO did not receive ‘specific purpose funding’ from the government.

**Table 4.1 Funds Allocated by the Government to the HWI Taskforce and the Growth of HWIs**

Budget Year	1996-1997	1997-1998	1998-1999	1999-2000	2006-2007	2007-2008	2008-2009	2009-2010
Funding (million A\$)	9.7	9.5	9.5	9.5	12.7	18.3	23.6	27.0
HWI Population (individual)	180	256	333	491	1140	1342	1669	2644

Source: Budget Paper No. 2 year 1996/97, 1998/99 for budget data and McAlister (2010) for HWI population data.

As the HWI population had grown almost fivefold in the intervening years, the Government provided additional funding of \$81.6 million to the taskforce in the 2006-07 Federal Budget, which was to cover the next four-year period until 2009-10. At this time, the HWI Taskforce was moved into the SME business line<sup>41</sup> as there was considerable commonality in taxpayers’ profiles and tax risks between certain HWIs and closely held private SME groups (Inspector-General of Taxation 2011, p. 10). Initially, the HWI Taskforce had been managed within the ATO’s Large Business and International (LBI) business line.

The continuing financial support provided by the Federal Government over eight years implies two conditions that underpinned the operation of the taskforce. First, it

<sup>41</sup> The ATO’s operations are managed through three groups: compliance; people, system and services; and law design and practice (Australian Taxation Office 2014). Each group is divided further into business and service lines (BSLs) or business lines. According to new ATO organisational structure, for instance, the former ‘HWI Taskforce’ is now called ‘private groups and high wealth individuals’ business line and is under the compliance group (Australian Taxation Office 2014).

demonstrates commitment from the Government of the day to ensure that the taskforce had a secure and important role within the ATO, to protect the integrity of the tax system, and at the same time to enhance the confidence of the Australian taxpaying community that the ATO's compliance activities were directed at the wealthy as well as ordinary taxpayers. Second, given that the budget had to be approved by the Parliament, funding for the taskforce was further legitimated by political support. These two elements, the support of the Government and Parliament, were important for the taskforce's prospects of success, considering the taskforce would be dealing with some of Australia's wealthiest and most powerful taxpayers with high public profiles.

The story outlined above shows that, in the Australian context, there was substantial political support for the HWI policy from both the left and right of the Federal Parliament. Such support legitimated the program in the eyes of the public and provided the program with secure funding. At the same time, the politicised beginning of the taskforce became a source of resentment among some segments of the population. The figure of \$800 million a year of unpaid taxes became 'a frequently cited focus of resentments' (J. Braithwaite 2003b, p. 251). Furthermore, according to Braithwaite, this led to a situation in which the Commissioner of Taxation at times was seen as 'a co-conspirator with the government in whipping up a 'witch-hunt' against HWIs' (p. 251).

In short, there were a number of reasons that led to the decision to establish an HWI unit in Australia in the mid-1990s. First, the ATO had to deal with public perceptions that HWIs did not pay their fair share of tax and that the ATO was being hard on general taxpayers while soft on the very wealthy. Second, HWIs used special tax arrangements to create and preserve their income and wealth that required a new administrative approach within the ATO to make sure that a well-informed, highly

skilled workforce could manage compliance effectively. Third, considerable tax revenue was at risk due to the higher likelihood of non-compliant behaviour among the HWIs, revenue which was required by a government dealing with a (perceived) budget crisis.

#### **4.2.2 The HWI Taskforce's objectives and processes**

The establishment of the HWI Taskforce followed an ATO study<sup>42</sup> of better ways of managing compliance when dealing with HWIs and the complexity of HWIs' business and tax arrangements. The HWI Taskforce had several objectives, which included (McAlister 2010; Parliament of Australia 2000; Senate Economics References Committee 2000):

- improving Tax Office understanding of HWI taxpayers and their group;
- identifying tax planning and minimisation practices employed by HWIs;
- improving voluntary compliance from that particular taxpayer segment;
- contributing to legislative amendments, particularly laws that removed tax minimisation opportunities; and
- building community confidence in the tax system by sending a message to the community that HWIs are seen to be complying with the tax system.

These objectives were formally and publicly disclosed.

In order to achieve these objectives, the Taskforce applied a 'holistic approach' (ATO 2008, p.8) to managing the tax compliance of the HWIs, that is, an approach that was based on understanding the entire business and financial affairs of groups effectively

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<sup>42</sup> The study was called Health of the System Assessment (HOTSAs) (The Auditor General 2000, p. 17). HOTSAs were required for all internal budget programs including the HWI program.

controlled (as opposed to legally owned) by the HWI. This means that the ATO brought all associated entities, both business and private, in which the HWI had a key decision-making role, together into the analysis (ATO 2008, p. 8; Inspector-General of Taxation 2011, p. 10), rather than assessing an HWI's personal return and the returns of the various entities under their control as separate returns.

Moreover, the Taskforce compiled a tax history of the individual and their group, together with information on business structures, financial and offshore arrangements, family connections, and details of specific transactions. Understanding taxpayer's individual circumstances and taking appropriate regulatory actions based on that understanding are important elements of the responsive regulatory style adopted in the ATO compliance model.

The holistic approach provided the ATO with a more thorough understanding of HWIs' compliance issues. Recognising the benefits of the approach, the ATO then applied it in other compliance programs such as that for 'wealthy Australians', those occupying the band of wealth below HWI (RA004, tax official).<sup>43</sup>

Australia's initiative, by monitoring HWIs and their related entities holistically, has been acknowledged by the OECD as an advantageous approach (OECD 2009, p. 60) for managing compliance of this particular segment of taxpayers due to the complexity of their business affairs. Some tax authorities have followed the ATO in implementing the approach, for instance the Inland Revenue (New Zealand) in 2003, the SARS (South

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<sup>43</sup> 'Wealthy Australians' are defined as 'those effectively controlling net wealth between \$5 million and \$30 million (Australian Taxation Office 2010b, p. 62).



Africa) in 2006, and the IRS (the United States) in 2009. Douglas Shulman (2009), the Commissioner of the IRS, acknowledged the adoption of the approach by saying:

*We've looked at what other countries have done ... So here's our game plan. Going forward, we will take a unified look at the entire web of business entities controlled by a high wealth individual.... Our goal is to better understand the entire economic picture of the enterprise controlled by the wealthy individual and to assess the tax compliance of that overall enterprise. We cannot do this by continuing to approach each tax return in the enterprise as a single and separate entity. We must understand and analyze the entire picture. (Emphasises added)*

The strategic reasoning behind monitoring HWIs is because they play a strategic role for all entities under their control in decision-making processes. They are the 'strategic foci of decision-making' (J. Braithwaite 2003b, p. 268). Identifying this feature of the HWI environment, recognising the poor fit between how HWIs operate and how the ATO operated with HWIs' entities falling in separate administrative lines, and finding a better way of adapting to the HWI environment, is an example of how a regulatory agency can show flexibility to utilise limited resources more efficiently (J. Braithwaite 2003b, p. 268).

In order to understand the 'bigger picture' of an HWI's business structures and its tax affairs, the ATO needs to gather information. Useful data may already be available in the internal system (e.g., tax returns, tax payments), and from other external sources such as states' land titles offices, the property sales database, the Australian Securities Exchange and commercial share registry, annual investment income reports from investment institutions, and other federal, and state or territory agencies, including the Australian Transaction Reports and Analysis Centre (AUSTRAC). Information from both internal and external sources provide the ATO with a base for profiling and risk-

assessing taxpayers and their related entities, as one respondent from an international organisation suggested:

You can't address the risk [from this particular taxpayer] if you don't have the knowledge; if you have no basis of assessing their potential; if you have no idea of how their affairs are structured...you have no basis for addressing [the] risk they represent. (RA014, international organisation)

To effectively analyse the information obtained in relation to HWIs, the taskforce has developed a system, known as the HWI system, which allows them to retrieve information, collate and integrate data, and map the relationship between groups of individuals, entities and transactions. Through this system the HWI Taskforce is able to determine the ownership of linked business and private entities, that is, who effectively controls the group, and to estimate the value of taxpayers' wealth based on that map (ATO 2008, p. 4).

These operations of the taskforce are an important example of organisational flexibility in responding to external demands and show considerable capacity to build networks across government departments, different levels of government and across both public and private institutions to gain the intelligence and knowledge needed to regulate the HWI sector.

#### **4.2.3 The performance of the HWI program**

When the HWI Taskforce was established in 1996, some believed that the newly elected government was primarily driven to collect revenue to reduce the budget deficit, as illustrated from an ABC radio interview: '...on the other hand the Government's obviously looking for revenue' (John Passant, academic, cited in McDonnell 1996).

Evidence for the truth of this belief can be seen in the Treasurer's Budget Speech before the Parliament (Costello 1996, pp. 1–2, emphasises added):

Our predecessors had Australia on a path of *deficit and debt* to the next century.

Our Government could not stand back and ignore the problem. Although we did not create it, we will take the responsibility to fix it.

Mr Speaker, you don't turn around a nation's finances, a nation's future without making some hard decisions. But if we avoid the hard decisions now they are only going to get harder in the future.

The tightening measures have to be fairly shared. We cannot expect those who rely on pensions and allowances – low income earners – to bear the cost. *So we are asking high income earners to make a contribution and business to make its contribution too.*

During the course of this research, however, it emerged in this way that revenue was not the only narrative within the ATO around the HWI Taskforce.<sup>44</sup> This is not to say that in Australia revenue derived from the HWI unit was not important, as a parliamentary hearing involving the taskforce's highest-ranking officials showed (Parliament of Australia 2000). Revenue collection from the HWI program is at the core of the accountability of the policy to the parliament.

The HWI Taskforce's performance can be categorised into four types: compliance work, risk assessment, revenue collection, and administrative and legislative responses (Senate Economics References Committee 2000, p. 59).

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<sup>44</sup> This is different from Indonesia where the achievement of targeted revenue is the main aim of the HWI initiative in particular and the tax system more generally – see Chapter 5.

### *Compliance work*

Conducting compliance activities refers to the effort that the tax authority (including the HWI Taskforce) makes in order to understand and influence taxpayer behaviour through education, persuasion, and sanctioning. The taskforce's compliance activities includes: identifying new HWIs, ongoing monitoring and reviewing risk assessment of identified HWIs, requesting additional information, escalating higher risk cases to review or audit, and prosecuting cases of serious non-compliance (ATO 2012a, p. 54). Table 4.2 presents a summary of ATO performance (1996–2012) with regard to the number of identified HWIs, compliance activities and revenue collection. Milestones are represented in the right hand column. It has been suggested that without proper compliance initiatives (including audit and prosecution) an HWI unit risks missing a valuable opportunity to increase its understanding of the HWI segment and its revenue collection (OECD 2009a, p. 61).

### *Risk assessment*

Risk assessment is the activity that the taskforce undertakes to assess whether there are risks arising from a taxpayer's self-assessment of their tax obligation. The HWI Taskforce uses three risk review steps which include: the preliminary risk review (PRR), comprehensive risk review (CRR), and specific review (SR) (ATO 2008, p.

28).<sup>45</sup> The ATO uses risk assessment to allocate its limited resources to areas which exhibit greatest risk and more importantly to minimise its intrusion into the affairs of low-risk taxpayers. See Table 4.2 for a comparison of the numbers of reviews and entities per annum.

**Table 4.2 The Australian HWI Taskforce's Performance (1996-2012)**

Year	HWIs identified	Reviews/ audits	Cash collected (cumulative since 1996)	Milestones/ Events
1996	180	-	Nil	HWI Taskforce established
1998	256	87/14	\$60.8 million	Shift from assessment to audit focus
2000	491	151/27	\$198.2 million	ANAO conducted performance audit and finds HWI Taskforce delivering Government outcomes
2002	608	230/28	\$512.1 million	Cash collections increase
2004	712	194/33	\$1.238 billion	Cumulative cash collections exceed \$1 billion
2006	943	275/38	\$1.542 billion	ATO receives \$81 million over 4 years for HWI program
2008	1342	439/27	\$2.114 billion	ATO receives \$89 million over 4 years for HWI program
2010	2644	852/31	\$2.271 billion	Improved data mining system sees doubling of HWI population
2012 (YTD)	2630	657/93	\$2.807 billion	HWI Taskforce is merged with the mainstream business line under the portfolio 'private groups and high wealth individuals'

Source: the ATO (2012a, p. 55).

<sup>45</sup> PRR forms an initial view of risk (or hypothesis) and acts as a filter before it is escalated to a more intensive review, which involves requesting information through questionnaires. CRR is used to develop a more in-depth understanding from what has been gathered from PRR; this involves requesting taxpayers to lodge an 'expanded tax return'. An expanded tax return is a form of tax return specifically tailored to the HWIs segment that includes the schedules for companies, partnerships, and trusts on top of the schedule of HWI as individual taxpayers (Australian Taxation Office 2013a). This return provides the taskforce with more comprehensive coverage of how HWIs and their entities determine their tax liabilities. SR is used to examine one or more specific risks that have been identified (e.g., specific transactions) (Australian Taxation Office 2008, pp. 28–31).

## *Revenue*

Revenue is the taskforce's most visible, high-profile performance indicator, and has been subject to scrutiny from its early years of the taskforce's operation. Since its establishment, the taskforce has collected revenue of \$2.807 billion (see Table 4.2). Direct (or cash) revenue refers to actual cash collection received in one particular year as a consequence of the taskforce's activities. This, as a consequence, does not include the net tax payable by HWIs and their associated entities that is paid where there is no taskforce action on the individual or entities concerned (The Auditor General 2000, p. 49). It also does not capture the general deterrence effect of the existence of the taskforce – taxes that would have been paid had there not been fear that the HWI Taskforce might detect the unpaid taxes. And it does not capture any other voluntary compliance effects that the non-punitive compliance work of the taskforce achieves. The figures in Table 4.2 are therefore likely to underestimate the value added by the taskforce. In terms of the compliance model, if the HWI unit is doing its job well, HWIs will judge it to be in their best interest to comply voluntarily because they do not want to direct effort to the ATO for review/audit/prosecution activity. The extent to which a regulator decreases opportunities for less compliance is an unknowable yet very important element in any analysis of regulatory effectiveness.

The HWI Taskforce attempted to attribute a change in tax compliance behaviour of HWIs and their related entities to compliance activities other than those directed at them, thus regarded as 'indirect revenue' resulting from the taskforce's work. In its report, ANAO (2000) suggested that such an attribution was 'difficult ... and certainly, cannot be proven as correct or otherwise' (p. 50). Indirect revenue outcomes of the

taskforce was measured by comparing the growth in net tax paid by HWI and their related entities with the growth in net tax paid by a larger population group from which they had been extracted (i.e., HWIs from business individuals, HWI-related companies from private companies). Based on data of early years of the taskforce operation (1996-97 and 1997-98) ANAO concluded that 'since the creation of the taskforce, tax paid by HWI-controlled companies has increased by more than that paid by other private companies' and considered that the derived indirect revenue figures claimed by the taskforce represented 'a reasonable estimate of indirect revenue resulting from the activities of the taskforce' (pp. 50-51). The most current data relating to this matter, however, are not publicly available.

#### *Legislative and administrative responses*

The other outcome of the taskforce is the structural reforms it has contributed to the tax system. By analysing HWIs' taxation affairs, the taskforce has been able to identify various tax planning techniques or arrangements which seek to exploit loopholes or grey areas in the law. Based on such analyses, the HWI Taskforce has provided the government and the Ralph Review of Business Taxation (1999) with advice which has resulted in initiatives, including legislation, to rein in several tax planning techniques in use by HWIs, as stated by Mr Carmody, Tax Commissioner at that time, before the Senate Economics Reference Committee hearing on 9 February 2000:

[T]he intelligence gathered from our operations has contributed significantly to the outcomes of the business tax review [Ralph Review of Business Taxation]. It should be noted as part of our responses to supporting compliance that it is not just a matter of enforcement or not just a matter of service, it is a matter of a wide range of factors including identifying and supporting proposals to the government where there are

deficiencies in the law. The high wealth individuals project has been an invaluable part of that. (Senate Economics References Committee 2000, p. E267).

Advice provided by the taskforce was then followed up by the government proposing changes in legislation through the Parliament:

We have provided advice to government over a period of time. Government has announced changes to law and the Parliament has passed changes to law in respect of some of that advice. It has foreshadowed reforms arising out of the Ralph review of business tax. Some of those measures have been enacted. I mentioned those loss [sic] integrity measures in particular. Others have been foreshadowed by government. (Mr Fitzpatrick, cited in Joint Committee of Public Account and Audit 2001, p. 95)

Tax reform measures introduced by the government that benefited from the work of the taskforce included taxing trusts in the same manner as companies, strengthening the accrual rules and transfer trust arrangements that apply to foreign trusts, removing the scope to create artificial losses and to duplicate losses, and extending fringe benefits tax to benefits provided to shareholders and beneficiaries (ATO 2000, p. 19).

To sum up, the institutional arrangement introduced by the ATO in the form of the HWI Taskforce to manage the tax compliance of HWIs was influential in changing the tax-paying behaviour of this taxpayer segment. The innovative approach that the taskforce employed, by integrating the monitoring of HWI-controlled companies, coordinating information-sharing networks, risk-assessing companies and groups, and reviewing legislation has generally been regarded as a positive contribution to the increase in tax paid by HWIs and their related companies (The Auditor General 2000, p. 51). The policy has been recognised as a successful and internationally distinctive risk-leveraging strategy (see also J. Braithwaite 2005, p. 85).



The evidence for the success of the Australian HWI program presented above is strong. The next question is, how do the operations of the HWI Taskforce connect with the more fundamental structural and cultural changes that took place with the introduction of the compliance model and *Taxpayers' Charter* into the ATO? In the next section I discuss the implementation of the ATO compliance model in the HWI initiative with particular attention to the application of some of the responsive regulation principles in the operation of the HWI Taskforce.

#### **4.2.4 The implementation of the ATO compliance model in the HWI initiative**

After the ATO compliance model was introduced in 1997 in the cash economy sector, it was rolled out throughout the ATO's business lines, with some adjustments according to the market in which the model was employed (J. Braithwaite 2003a). The HWI Taskforce was established before the model was introduced. Nevertheless, it was required, like other business lines and groups, to integrate compliance model thinking into its operations. In order to show how the ATO compliance model is a supporting element of HWI policy and administration, in this section I discuss practices the taskforce adopted from the ATO compliance model's principles, namely: understanding taxpayer behaviour through a holistic approach; building community partnerships through taxpayers' 'networks of influence' (Rawlings 2005) in the business sector and financial sector; sending clear signals in advance to taxpayers and their advisers through the HWI booklet; and building compliance through greater flexibility to encourage and support voluntary disclosure initiatives (J. Braithwaite 2003b, p. 269; Cash Economy Task Force 1998, p. 26).

*(1) Understanding taxpayers' individual circumstances*

Understanding taxpayers' individual circumstances is an important feature of the compliance model, in that it determines the actions the ATO undertakes in response to any particular non-compliance stance or risk of non-compliance. The HWI Taskforce has adopted the principle of understanding taxpayer behaviour in a sophisticated way (J. Braithwaite 2003b, p. 269). The task requires a micro-macro analysis, that is, involving compilation of a tax history of the individuals and their group (micro level) while also monitoring macro conditions (e.g., a significant lift in commodities exports) and examining tax payments to check whether or not they reflected these macro conditions. The initial task was challenging.

Putting them together ... putting that picture [of HWIs together] and dealing with the very complex [tax] law. That's probably the biggest challenges. (RA005, tax official)

The critical thing is you need to understand your population.... (RA006, tax official)

If you can't start with some insights on how these taxpayers operate, how they derive their income, [and] how their affairs are structured, you don't have any basis for conducting proper investigation of their affairs; whether they comply or not. (RA014, international organisation)

After more than a decade of experience derived from the taskforce's method, and using sophisticated diagnostics, the ATO understands how to map privately owned entities and to trace the individuals in control (ATO 2011).

The ATO can allocate its limited resources to the taxpayers that demonstrated the greatest risk of failing to meet their compliance obligations. Taxpayers assessed as low-risk are given the opportunity to self-regulate themselves so as to minimise the intrusiveness of ATO compliance activities. Risk differentiation and tailored

compliance actions are only possible through the Tax Office investing time and resources in the difficult task of gaining a better and thorough understanding of HWIs and their associated entities.

*(2) Building community partnerships*

Partnerships that the ATO built with the community was aimed at improving intelligence and developing shared community understanding, an essential element underpinning the compliance model (Cash Economy Task Force 1998, p. 31). In the context of HWI taxpayers, building strategic relationships helped the ATO in developing its understanding of taxpayers' practices. This aspect of compliance model thinking when applied to the HWI Taskforce also involved establishing task Force legitimacy and maximising prospects of cooperation and compliance among HWIs. In the context of HWIs, their community may include accounting firms, tax advisers, and legal advisers through whom HWIs seek advice in relation to their business and tax affairs; professional bodies (e.g., the Taxation Institute of Australia, National Institute of Accountants, and Certified Public Accountant Australia) who provide the ATO with policy recommendations; or industry associations through which HWIs or their entities lobby government and influence opinion about future policy directions. Partnerships with other elements of civil society such as NGOs that are concerned with taxation issues (for example, the Tax Justice Network) also prove valuable to the Tax Office, although traditionally the ATO has 'less vigorously pursued' such partnership (J. Braithwaite 2005, p. 73).

Building partnerships with the HWI community can also be seen as a way for the ATO to develop a 'web of influence' (Braithwaite & Drahos 2000, chap. 23) of tax compliance of the very wealthy through a dialogic approach. Braithwaite's (2003b)

study found that advisers play an important role in securing the compliance of the very wealthy. Because tax practitioners play a pivotal role in the Australian taxation system (Tomasic & Pentony 1990; Wurth 2012), it is desirable to involve the profession in the process of improving taxpayers' compliance in a more formal way.<sup>46</sup> Tomasic and Pentony (1990) argued that tax practitioners not only acted as intermediaries between the Tax Office and the taxpayers, but they also influenced 'the ethical climate and level of compliance with taxation laws' (p. 1).

Because high wealth individuals never understand ... they don't understand the complexity of the tax laws. They put it in the hands of the advisers and they say: 'you go away and do it', and the advisers do it. And ultimately, they [HWIs] are responsible for what goes in the tax return. (RA014, tax official)

Current studies (e.g., Tan 2009; Wurth 2012), however, reveal that taxpayer-tax practitioner relationships are far more complex than Tomasic and Pentony suggested. Using a Tax Practitioner-Client Role Model, Tan (2009) found that aggressive tax decisions employed by taxpayers arise from a complex interplay between taxpayer and practitioner. Tan argued that the conservativeness or aggressiveness of the advice that practitioners give to their clients is associated with their assessment of the likelihood of clients being audited or sanctioned, risk propensity, their perceptions of the needs and expectations of the other, and trust in the relationship.

Using a propensity and opportunity model for tax practitioner preparation compliance, Wurth (2012) concluded that tax practitioners form distinct and very different clusters

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<sup>46</sup> Tax practitioners refer to 'all those who are paid by clients (taxpayers) to assist them with their compliance work or to provide advice on tax planning' (Tan 2009, p. 11). The terms used include tax practitioners, tax preparers, tax professionals, professional tax advisers, tax consultants, tax specialists, tax agents, tax lawyers and tax accountants.

of preparation compliance: from the ‘duteous’ cluster which exhibited the most virtuous approach to preparation practice and had the highest level of compliance, to the ‘outlier’ cluster which represented ‘an extreme version of the [a]ggressive pattern of results’ (p. xv). The ‘aggressive’ cluster, according to Wurth, is those who voice a compliant approach to preparation practice and yet report the highest level of non-compliance within their clients’ returns. Also of great interest were the ‘contingent’ group who watched the ATO for signals of what was acceptable for reducing tax and what was not. Wurth suggested that recognising that there are multiple distinct groups of practitioners who hold different propensities and perceive different opportunities for non-compliance, is important for regulators as they tailor their regulatory strategy.

Building partnerships with tax advisers to improve compliance of the HWI segment was part the HWI Taskforce’s strategy:

So ... part of the strategy is engagement. Go and talk to advisers, explain what we’re seeing and get them involved, because the Taskforce has identified that most of the wealthy individuals are represented by accounting firms. (RA006, tax official)

This kind of engagement is captured in a formal and regular consultative forum with major accounting firms (ATO 2008, p. 9), at which the ATO advises them about what its plan is, and at the same time discusses compliance risks in relation to the HWI segment, gaining knowledge and information from stakeholders in the process.

### *(3) Sending a clear message in advance to taxpayers*

The basic logic of responsive regulation is that most people will abide by the rules without a lot of intervention because they see clearly that the regulators have a clear strategy and adequate resources to increase sanctioning in response to ongoing non-

compliant behaviour (Ayres & Braithwaite 1992; Braithwaite 2010). The taskforce has implemented this principle by publishing a booklet called *Wealthy and wise: a tax guide for Australia's wealthiest people* (ATO 2008).<sup>47</sup> In general, the booklet is aimed at: describing strategies the ATO employs to ensure compliance of the very wealthy; outlining taxpayers' characteristics that influence how the ATO collects information and responds to compliance risks; setting out factors that the ATO will review, and its compliance process based on that review; and suggesting ways that HWIs can endeavour to better manage their tax affairs to reduce the risk of non-compliance (ATO 2008, p.3). As a communication vehicle between a tax authority and taxpayers, the booklet's ultimate objective is sending a clear message about the Taskforce's mission so that HWI taxpayers and their advisers understand how the Taskforce works and what strategies are available to secure compliance.

According to one senior HWI Taskforce officer the strategy is effective:

Because the booklet not only told them what we could do to them, it makes it quite clear what we expect of them in return. And agents are quite happy with that because they have a bit of certainty, they can go back to taxpayers and explain to them: 'Look, this is what we have to do; this is what is required from us'. (RA007, tax official)

Clear, respectful and honest communication is an essential element of responsive regulation, and also of the *Taxpayers' Charter*.

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<sup>47</sup> In September 2012 the booklet was revised and is called *Small-to-medium enterprises and wealthy individuals: our compliance approach* (Australian Taxation Office 2012c). The new booklet provides information on the ATO's process in managing the compliance of this segment, including its risk assessment procedures and its compliance approaches. It also explains how the Tax Office uses a 'private group approach' and how it is used to identify and profile wealthy individual taxpayers and their associated entities (Australian Taxation Office 2012c). The revised booklet incorporated the implementation of recommendations provided by the Inspector General of Taxation (Inspector-General of Taxation 2011). The new version of the booklet extends its scope, to include not only the HWI segment but also the entire SME market segment. More importantly, the revised booklet incorporates stakeholders' feedback.

*(4) Building compliance through greater flexibility to encourage and support compliance*

The responsive regulatory model adopted in the ATO compliance model advocates an escalating range of enforcement options and sanctions. This approach requires the ATO to presume that the majority of taxpayers are ‘good citizens’ and would be willing to comply if they understood the tax system and were treated fairly with trust (Cash Economy Task Force 1998, p. 41). In adopting this principle the ATO introduces initiatives that reflect the trust that it places in taxpayers. One senior official in the taskforce described how this principle is practised as follows:

OK, under self-assessment I’m saying ‘Look, I trust you to do [the] right thing ... I’m not going to check everything that you’ve done. But with that comes some responsibilities. If you think you’ve got a problem with tax and you [unfinished sentence] ... I think I want you to get used to the idea that you should come forward and discuss it with me in the first place. Rather than you wait until I do an audit many years later, because that can be very expensive’. (RA04, tax official)

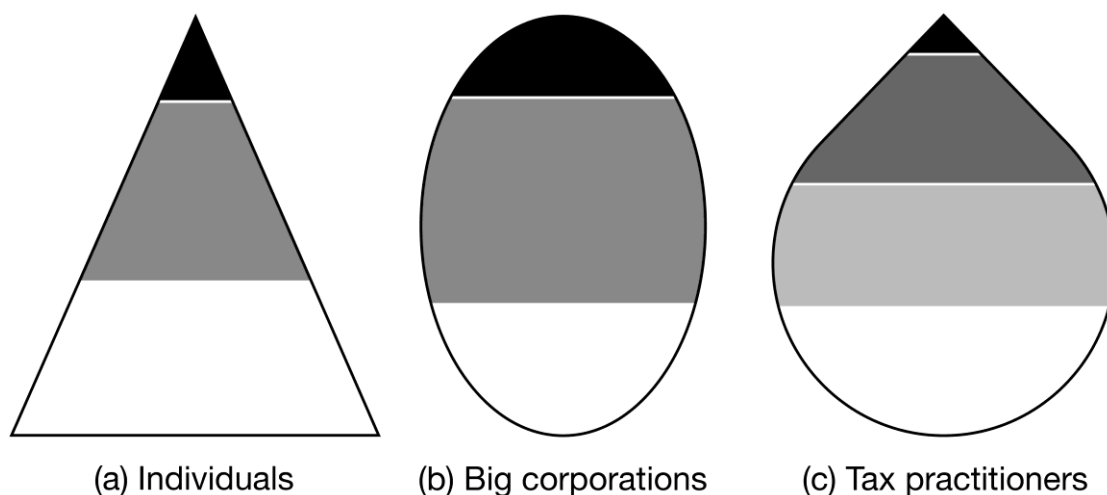
Initiatives such as voluntary disclosure where taxpayers are encouraged to advise the ATO of any changes or of any errors in their tax returns, with reward in the form of penalty reductions, or the remission of interest on tax shortfalls in exchange, is an example of how the regulatory strategies are pushed down to the bottom of the pyramid by communicating to taxpayers a respect for their capacity to self-regulate and for them to be trustworthy (V. Braithwaite 2003a). This initiative is not exclusively for the HWIs, although the amount of tax revenue potentially at stake is considerably higher for the HWI cases than general taxpayers so it makes this initiative more relevant to them. At this point it is worth noting that the compliance model emphasises cooperation, trustworthiness and self-regulation at the bottom of the pyramid, but also clearly

communicates that breaches of the trust will lead to escalation up the pyramid, which can rapidly lead to the use of highly intrusive measures if they are called for.

As noted above, patterns of tax compliance among citizens are thought to form a pyramidal shape with the majority of taxpayers having the intention to do the right thing at the base of the pyramid, and, with fewer and fewer taxpayers populating subsequent levels going up the pyramid (J. Braithwaite 2003a, p. 179). This, however, may not be the case with other tax populations, including large corporations, HWIs and tax advisers.

John Braithwaite (2003a) has argued that corporate tax compliance forms an egg-shaped pattern, with most taxpayers playing for the grey (see Figure 4.3). That is, the majority of taxpayers in this group are satisfied with a ‘reasonably argued position’ rather than aspiring for compliance with the spirit of the law (J. Braithwaite 2003a, p. 179). Wurth’s (2012) teardrop model of practitioner compliance shares similarities with the egg-shaped interpretation, and supports the argument that using legitimate avenues for tax minimisation and finding a reasonably argued position has become a widely accepted norm for being an ‘honest’ taxpayer in Australia.





**Figure 4.3 Alternative models of tax compliance patterns of individuals, big corporations and tax practitioners (the pyramid, the egg, the teardrop)**

Source: Braithwaite (2003a, p. 180) and (Wurth 2012, p. 142).

No matter what tax compliance patterns are formed by particular groups (individual taxpayers, large businesses or tax practitioners), the basic idea of the compliance model is that the ATO and its officials should invest in discovering the content for them that is relevant to the context in which they operate (J. Braithwaite 2003a, p. 178). Through understanding content and context, tax officials are able to provide taxpayers who are willing to comply with adequate supports, while at the same time demonstrating power to punish those who choose not to comply.

The concept of responsive regulation has entered into tax research thinking. For instance the idea is adopted in Kirchler et al.'s 'slippery-slope model' (Kirchler 2007, sec. 7.3; Kirchler et al. 2008). The slippery slope framework suggests that in order to secure compliance, it is important to consider the position the authorities adopt towards taxpayers. The framework assumes that compliance can result under the condition of the authority's strong power as well as under the condition of trust in authorities. When taxpayers trust the authority they are more likely to consider it legitimate and will defer

to its assessments and cooperate. In other words, voluntary compliance is high if interaction with authorities is trusting. Trust can be built through the ‘service and client approach’ (Kirchler et al. 2008, p. 220). According to Kirchler (2007, p. 204), such an approach is characterised by clear and understandable regulations, transparency of procedures, neutrality, respect and politeness with regard to taxpayer treatment, as well as support. These are also elements that feature prominently in Tyler’s (1990) work on procedural justice (see also Tyler et al. 2013), applied to the tax context by Murphy (2004b).

### **4.3 Principles, mechanisms and actors in the implementation of the HWI initiative in Australia**

This chapter so far has shown how a policy initiative, namely an HWI Taskforce, in a well-established and resourced tax authority like the ATO, operated in a way that integrated its activity with many influential networks in government and outside. Furthermore, its operations were supported by the ATO compliance model that extended across the whole ATO, and by the *Taxpayers’ Charter* which was in effect a memorandum of understanding with the community informing them of their rights and how the ATO would treat them. The HWI Taskforce was enmeshed in a taxpaying culture and governance structure that supported its mission and its operating procedures. From the perspective of policy transfer, the cultural underpinning and the governance structure were important considerations in setting up a similar administrative arm in another tax jurisdiction.

The Indonesian tax collection culture is vastly different from Australia as are the resources at the disposal of the DGT; these issues are discussed in the next chapter. A more positive path to follow in addressing the question of how a policy can be

transferred successfully from a mature to a developing economy is to address the processes of forming policy, informed by other experiences, but suited to the cultural context in which it is to be implemented. It is in this regard that the principle-mechanism-actor frameworks of Braithwaite and Drahos (2000) proved helpful.

#### **4.3.1 Principles underlying the operation of the ATO and HWI Taskforce**

The principles that the ATO hold are in the public domain. Three are particularly prominent.

First are the principles of the ATO mission statement: ‘We contribute to the economic and social wellbeing of Australians by fostering willing participation in the taxation and superannuation systems’ (ATO 2013b). The mission statement recognises the importance of having voluntary compliance, commits the ATO to contributing to the wellbeing of Australians, and embraces the importance of both economic and social wellbeing. The mission statement recognises the importance of revenue collection but that it must be done in a principled way.

The second declaration of principles involves accountability with regard to the ATO’s operations. Accountability takes the form not only of openness to review by external institutions (e.g., parliamentary committees, the IGT, the Commonwealth Ombudsman, or the ANAO) but also openness with the community about how they achieve their objectives, including ATO planning documents.

The third principle that feeds into ATO operations is the *Taxpayers’ Charter*. The *Charter* sets out the way the ATO and its officials conduct themselves when dealing

with taxpayers through articulating the 13 principles set out in Table 4.3.<sup>48</sup> Since it was introduced in July 1997, the *Charter* has been revised, most recently in November 2003.

The *Charter* reinforces the compliance model and vice versa in the ATO's commitment to being more client-focused. This is recognised explicitly in the HWI booklet:

The guiding principles underpinning our approach to working with taxpayers are reflected in *the taxpayers' charter and our compliance model*. This involves mutual respect and a professional relationship based on a shared understanding of the tax law in identifying and evaluating compliance... [The compliance model] is a structured way of understanding compliance behaviour, and helps us respond according to: the nature and level of risk we identify; the causes of non-compliance; and the level of cooperation we receive. (ATO 2008, p. 9, my emphasis)

The principles of the ATO place constraints on how freely the ATO can pursue its revenue targets. This is particularly evident in the values of the mission statement. Nevertheless, revenue targets remain important. The history of Australia's HWI Taskforce outlined earlier in this chapter shows that the HWI was set up initially as a response to perceived risk to tax revenue due to tax minimisation techniques practised by the very wealthy.

**Table 4.3 Principles Embedded in Australia's *Taxpayers' Charter***

No	Principles
1	Treat you fairly and reasonably
2	Treat you as being honest in your tax affairs unless you act otherwise
3	Offer you professional service and assistance
4	Accept you can be represented by a person of your choice and get advice

<sup>48</sup> When the *Charter* was introduced in 1997 it included 12 principles. In 2003 the *Charter* was reviewed and extended to 13 principles.

No	Principles
5	Respect your privacy
6	Keep the information we hold about you confidential
7	Give you access to information we hold about you
8	Help you to get things right
9	Explain the decisions we make about you
10	Respect your right to a review
11	Respect your right to make a complaint
12	Make it easier for you to comply
13	Be accountable

Source: ATO (2010a)

Moreover, the taskforce was always under pressure in relation to how much tax revenue it could generate. The issue of accountability was raised in a Senate Committee hearing held on 3 November 2000, as pictured in the exchange in Box 4.2 (Parliament of Australia 2000, pp.98–99). On the one hand, this exchange illustrates the pressure on the ATO in relation to revenue. On the other hand, the exchange demonstrates the principle of accountability, especially to the Parliament.

Although revenue generated from the taskforce activities must be reported and has been the concern of both the government and the Parliament, it has not necessarily made the achievement of revenue targets the only policy principle colouring the efforts of the taskforce. Rather, the HWI initiative was set up primarily as an effort by the ATO to gain public confidence in the integrity of the tax system and change the view that the ATO was tough on average taxpayers but lenient on the very wealthy. As these respondents in the HWI taskforce revealed:

My guess is ... at that point in time the focus was making sure that that segment of the taxpayer population [high wealth individuals] was seen to pay their fair share of tax ... and be able to prove to the community that we are doing something about this part of the community not paying their fair share of tax. Because there was a perception in the community at that time ... [supported by CTSI research<sup>49</sup>] that people suspected that this part of the taxpayer population weren't paying their fair share. That was the perception, so whether it's true or not is another question, but that's the perception ... Sometimes the tax office needs to be out there to be seen to be dealing with perceptions and addressing people's concerns and that's why we started it off. (RA007, Tax official, my emphasis)

This is another argument for an indirect effect discussed earlier beyond the AUD\$ 2.8 billion tax revenue. That is, it could be that by increasing the legitimacy of the tax system HWI Taskforce contributes to voluntary compliance by low and middle income taxpayers.

[Achieving increases in] revenue was not the only objective of the establishment of the taskforce ... non-monetary outcomes are also important, such as improved public confidence in the tax system. (RA002, Tax official)

The ATO's deputy commissioner, Michael Cranston, discussed similar issues in a media interview (Vedelago 2014).

If the broader population sees that we make sure that the rich – who can really afford to pay taxes – pay, then it's fairer for them and they are more willing to pay their taxes too. It's not just for the return on investment [of the HWI initiative] but the community's expectation we will deal with wealthy people.

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<sup>49</sup> Research by the Centre for Tax System Integrity at the ANU undertaken in partnership with the ATO 1999-2005.

**Mr Kelvin Thomson** [Member of Parliament]: Does the tax office have some feel or estimate for revenue which has been either collected or saved as a result of the measures to which you have referred?

**Mr Fitzpatrick** [First Assistant Commissioner]: I have got no estimate of the revenue impact of those measures.

**Mr Kelvin Thomson:** It is a highly relevant question as to what has become of the \$800 million and the \$700 million gap between what was said at the start of 1996 and what was subsequently reported as to whether the measures that are outlined here and to which you have referred have been able to generate or save the \$700 million. So my query is: do you have some feel for that?

**Mr Fitzpatrick:** Certainly the measures outlined here, and I have referred to previously, will have an impact on the revenue which we estimated to be at risk in respect of some high wealth individuals arrangements. From our experience it is clear that some of those taxpayers will look for other opportunities on an ongoing basis. We need to be alert to those as best we can to address whatever new opportunities arise, and that is certainly a clear focus of our intention at the moment.

**Mr Kelvin Thomson:** It is not particularly satisfying to me for you to respond that it will have an impact and for me or others not to be able to get any feel for the quantum of the impact, the dimension of it, whether it goes to the \$700 million gap or it does not. I might direct the same question to Mr White from the ANAO in terms of the Audit Office investigation of this area, whether you then get from this some suggestion as to whether these legislative measures have been effective in recovering the \$800 million or whether they have not.

**Mr White** [Executive Director ANAO]: Our report in discussing the \$800 million makes it clear from the information we saw from the tax office that the \$800 million is an order of magnitude estimate of revenue that could be gained from both audit activity but also from various legislative changes if they were to occur.

#### **Box 4.2 Dialogue at Senate Committee Hearing, 3 November 2000**

Source: Parliament of Australia (2000)

These principles of contributing to economic and social well-being through voluntary compliance and cooperation with the Australian public, of being accountable to the government, Parliament and the community, and of acting according to the *Taxpayers' Charter* shape the way in which the ATO and the HWI Taskforce function in their collection of revenue. Principles influence the mechanism used for revenue collection. The compliance model is a strategic tool that crosses over from principles to practice. As a strategic tool it houses and gives meaning to several specific mechanisms in the ATO context. Among these specific mechanisms are a holistic approach to managing compliance among HWIs and risk leveraging.

#### **4.3.2 Mechanisms: monitoring compliance through a holistic approach and risk leveraging**

In order to work holistically to improve HWI tax compliance, the ATO required specific mechanisms that enabled data linking and matching, to claim priority and to access cooperation from other business lines within the ATO.

##### *Data linking and matching*

In contrast to publicly owned companies, information about the existence, operation and finances of a closely held private group (CHPG) linked to a particular HWI was not publicly available. Moreover, the business structures and governance processes of CHPGs are less transparent than those of public companies. Yet the ATO's ambition involved sketching relationships between grouped entities, including individuals, trusts, and partnerships, and determining the ultimate individual who had effective control (as opposed to legal ownership) over them. The importance of the task for a tax authority trying to establish its HWI initiative was reflected in these comments from HWI Taskforce officials:



That's why it's vitally important to have a system to capture the links, because it helps run your business. It's very important ... very important to have a system that captures those links. (RA004, tax official)

We link them, we have a computer system called the HWI System and once you identify a high wealth individual, we would link all of the entities that that person had control of. (RA003, tax official)

Identifying wealthy individuals and their related-entities is only possible if the ATO facilitates mechanisms through which the taskforce is able to retrieve, collate and interrogate data from taxpayers managed by other business lines within the ATO or scattered in various governmental and non-governmental agencies.

*Claiming priority and accessing cooperation across business lines*

Entities that link to a particular HWI are typically diverse (ATO 2008, p. 5), which means they are very likely to be administered by different business lines within the ATO. In order to effectively and efficiently monitor the tax compliance of the HWIs and their related entities, the taskforce has to have power to access information about these 'scattered' entities from other parts of the ATO.

Cooperation across business lines is institutionalised through a priority rule. The ATO introduced a rule whereby other business lines need to gain approval from the HWI assigned officer before doing any compliance work with entities that have been indicated as HWI-related (RA011, tax official). In practice, except for certain work such as tax return lodgement and debt collection, the HWI Taskforce has a prior claim on any compliance works with entities that are flagged with a 'HWI indicator'. Other business lines within the ATO (e.g., in the old structure they included the SME and the LBI business lines), were expected to offer their cooperation to the HWI Taskforce.

So [for example], if LB&I [large business and international] came along and they wanted to undertake some audit activities in respect to this company, they would need to coordinate that with the HWI Taskforce. They would need to say: 'Are you undertaking any compliance action in respect to this company, because we intend to?' And we say: 'No, you can't, because we're already doing an audit'. So, that's how it works in terms of audit.

... Any compliance actions or any actions from other business lines had to get a clearance from the HWI Taskforce for them to do or not; depending what actions we had planned. So that sort of bureaucracy cross over ... in essence we had ... the HWI Taskforce had priority of the most of those. If not, it is going to be discussed at a higher level: what works and who is going to do what. (RA011, tax official)

### *Risk leveraging*

The other mechanism used to monitor tax compliance of the HWIs and their related entities is risk leveraging. Risk leveraging means that the ATO categorises taxpayers based on the risks they demonstrate. Using an 'entity questionnaire', the Taskforce requests full details of all private entities associated with an HWI that enables them to sketch the business group of one particular HWI. Combined with other information already available at the ATO (e.g., tax returns, business activity statement (BAS), tax payments) and obtained from external sources, responses from the questionnaire are used by the Taskforce to do risk assessment. The Taskforce then follows up taxpayers who exhibit high risks by asking them to complete an 'expanded tax return'. This responsive regulatory approach aids compliance in this sense:

... the genius of the expanded return is that it puts HWIs in the position where they have to lie outright rather than 'overlook' something. It forces into black and white what had previously been grey. Both conscience and fear of deterrence work better in the realm of black and white than in the realm of grey. This point applies to both HWIs themselves and to their advisers. (J. Braithwaite 2003b, p. 267)

That is, by responding to the ATO's request and completing an expanded return, the Tax Office reduces the degrees of freedom for redefining income and deductions for the purpose of a subsequent return: If X was reported in a 2012 return, taxpayers' degrees of freedom to re-configure their 2013 affairs in such a way that X was not consistently reported are reduced (J. Braithwaite 2003b, p. 267; Braithwaite et al. 2003, p. 206).

Expanded returns were the break through mechanism that started an agreed process for holistic data collection and system building discussed earlier. It was suggested by the ATO, challenged by tax agents (J. Braithwaite 2003b), and eventually put into place after much dialogue with external stakeholders (RA002, RA004, RA005, tax officials).<sup>50</sup>

The application of the expanded tax return is also viewed by tax practitioners as 'a real deterrent against aggressive tax planning' (Senate Economics References Committee 2000, p. 60) (another impact that goes beyond the direct \$2.8 billion revenue), as also described by an adviser in Braithwaite's (2003b, p. 250) study:

The more information he's [the Commissioner] got, the less aggressive they will be in their tax planning.

Despite its advantages, this mechanism had its critics (J. Braithwaite 2003b, p. 247–248). In the early days expanded returns were applied for all HWIs, regardless the risk they exhibited to the revenue. Therefore, taxpayers 'complained bitterly' (RA002, tax official). Complains and criticisms were related to the compliance cost that taxpayers

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<sup>50</sup> Thanks to Dr Andrew Stout of the ATO for reminding me to acknowledge the 'expanded return' process as an example of dialogic webs that the ATO developed with the HWI policy stakeholders such as tax advisers.

should bear for completing the expanded tax return in the forms of professional fees paid to the advisers for giving advice and of the cost of the HWI and staff's time that was allocated for completing the return.

Practice has changed. The expanded tax return is now simpler and shorter and low risk HWIs were omitted after a period of time. HWIs who were identified as high risk continued to have more intrusive and expensive expanded return required each year.

Under its compliance model strategy that integrates principles and frames mechanisms, the ATO (as noted earlier) invested in data linking and matching, claiming priority and accessing cooperation, and risk leveraging through an entity questionnaire and an extended tax return. These mechanisms enabled the HWI Taskforce to meet its revenue targets while abiding by principles encapsulated in the ATO mission statement, accountability, and the *Taxpayers' Charter*.

#### **4.3.3 Actors: gaining supports from different directions**

In implementing the HWI policy, the ATO needed supports from different actors, at different point in time, and for different purposes. Four categories of actors have contributed to the success of the implementation of the HWI initiative in Australia: politicians, tax practitioners, tax officials and other agencies.

##### *Politicians and political institutions*

Support from politician and political institutions for the ATO in general and the Taskforce in particular gives the HWI policy legitimacy and authority. The HWI initiative in Australia had political support from the very beginning, as one respondent who had been in the taskforce since its inception revealed:

... we had political support right from the word go. That is the advantage we had and I also mentioned to you the way in which, under our constitution, the Tax Office was set up to ensure its independence ... that was a great way of helping us as well ... (RA007, tax official)

Political support was also manifested through not intervening in the operation of the taskforce.

I received a lot of letters from them [HWI taxpayers], but there've been complaint letters where they complained to the Prime Minister and the Commissioner of Taxation ... It's interesting ... when they've complained to the Prime Minister you hear nothing at all from the Prime Minister's office. Politically I think in Australia it would be suicide if they were to support someone who's evading tax. Especially ... if they came to support that person and then we ... ended up in the courts, then the Prime Minister would have looked pretty stupid having supported someone who broke the law. (RA004, tax official)

Political support to the taskforce also was provided through funding in the budget. This specific purpose funding (Joint Committee of Public Account and Audit 2001, p. 60) can be interpreted as political support received by the taskforce from both the Parliament and the government.

### *Tax practitioners*

Tax practitioners play an important role in Australia's tax administration context. They lodge around 71 per cent of individuals' tax returns and more than 95 per cent of businesses' (ATO 2011, p. 37), not to mention the role they play in providing tax-related advice which also influences taxpayers' compliance behaviour.

Tax professionals are prominent in the context of HWIs, in that they provide HWIs with advice in relation to their personal as well as business tax affairs. In recognising the important role tax professions play in influencing voluntary compliance, the ATO has

been involving tax practitioners in the implementation of the HWI initiative since its very beginning. As mentioned previously, the involvement of tax practitioners occurs in the form of a consultative forum at which the taskforce discusses major risks in relation to wealthy people and the design of products that support taxpayers in fulfilling their tax obligations.

We are increasing our engagement with tax practitioners and advisers managing the affairs of these people [high wealth individuals]. We will work with key intermediaries to co-design products that help taxpayers achieve practical certainty and reduce ongoing compliance costs. (ATO 2011, p. 17)

Tax practitioners constitute an important factor in the management of tax compliance in Australia (Rawlings 2005, p. 25; see also Ryan 1989; Tan 2009; Wurth 2012). Involving tax practitioners in the effort to improve compliance of HWIs involves using a ‘network of influence’ (Rawlings 2005) of those moving in the HWIs’ circle.

It’s about ... getting out there and making the professions who represent the high wealth individuals – the major law firms or the major accounting firms – aware of us, and what we do, and the processes [that we undertake]. (RA003, Tax official)

So part of the strategy is engagement. Go and talk to advisers, explain what we’re seeing and get them involved ... we have regular meetings with accounting firms with regard to this market or this population ... we talk to them on a regular basis ... that engagement will help to improve the level of compliance. (RA006, Tax official)

... the predominant people providing advice to the HWI are tax agents, they are the ones who are providing advice and saying how the law should be applied, or how they should restructure [their business], or how they should try something different ... so therefore having contact with tax agents is crucial in this regard. (RA011, Tax official)

### *Tax officials*

Tax officials are affected by newly introduced policy, as occurred with the introduction of the ATO's compliance model (discussed in Chapter 2). Tax officials' understanding of the policy objectives is required for the success of the policy's implementation. In its performance audit of the HWI Taskforce, the Auditor General revealed that:

... staff interviewed by the ANAO ... appeared to understand the activities and projects that the taskforce was required to achieve ... Moreover, taskforce staff indicated that they were committed to the success of the taskforce in meeting its required level of performance, and making an individual contribution towards that success. (The Auditor General 2000, p. 27)

Staff's understanding of policy objectives can only be achieved if the policy objectives are shared evenly among them, especially those at operational levels.

The ANAO considers that the taskforce planning is well structured; that it is understood by taskforce staff; and that it contributes to achievement of, and reporting on, the operational outcomes required of the taskforce. (The Auditor General 2000, p. 27)

### *Other agencies outside the ATO*

Other institutions outside the ATO supported the success of the taskforce operation, most notably through the provision of information.

We started mining the data within the ATO, we started using external databases, any information we could get on hand, even a newspaper article which says that Mr X had sold a large proportion of a particular business and it made three hundred million dollar profit ...When I say external databases it was like a property database, it was like a boat register or other thing which would kind of add to the picture of their wealth. (RA004, tax official)

Data sharing frameworks (with governmental and non-governmental agencies) are only possible if regulatory arrangements are in place to allow that to occur. In Australia, such arrangements are determined by laws such as the *Privacy Act 1988*, the *Data Matching Program (Assistance and Tax) Act 1990* and the *Tax Laws Amendment (Confidentiality of Taxpayer Information) Act 2010*.

## **Conclusion**

This chapter has described the HWI initiative (Taskforce) introduced in Australia in May 1996. Although the focus of the taskforce's work was ensuring compliance of the very wealthy with Australia's tax laws and code, cultural background, frameworks, principles and mechanisms shape the way in which the taskforce practises its craft. In terms of culture, the most influential framework is the ATO compliance model, developed on the basis of a responsive regulatory approach to tax compliance and implemented in 1998. The ATO uses the model to gain a better understanding of taxpayers' individual circumstances and to provide them with a proportionate and appropriate response to the compliance problems that taxpayers exhibit. The compliance model is complemented by the *Taxpayers' Charter*, introduced as a service charter in July 1997, and revised in November 2003 to extend the idea of a partnership between the ATO and taxpayers with taxpayer responsibilities being added to the list of service promises.

The compliance model and the *Taxpayers' Charter* are important aids in implementing the higher-order principle of maintaining public confidence in the integrity of the tax system, to ensure accountability and put the ATO mission statement into practice. HWIs, like ordinary taxpayers, should be treated reasonably and fairly, but also they should be held accountable to pay their fair share of tax. More specifically, the HWI



initiative sought to assure the public and the Parliament that the tax system works fairly; that is, those who are wealthy do not take advantages of the laws because of their access to sophisticated tax planning arrangements.

Principles are translated into policy mechanisms that make it possible for the taskforce to monitor the tax compliance behaviour of HWIs through a holistic approach. The holistic approach involves looking at the compliance behaviour of a HWI and all related entities as one case. These cases are managed within the HWI unit with cooperation from other business lines, using a risk assessment to concentrate efforts and resources and reduce intrusion into the affairs of low-risk taxpayers.

The implementation of the HWI initiatives required involvement from and support of different actors to ensure its success, since the very wealthy are privileged, powerful and politically influential. The HWI initiative had strong political support from all sides of Australian politics. Moreover the taskforce had special funding support of \$119.8 million from the government for eight years.<sup>51</sup> The taskforce built networks with tax practitioners, with both government and non-government agencies for the purposes of information gathering, and devoted effort to explaining to staff at the operational level what the high wealth policy was about and how they were to contribute.

Understanding that there are other elements in the Australian tax system that underpin the operation of the HWI program is a crucial part of learning about this policy before

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<sup>51</sup> That is, from budget year 1996-97 until 2009-10. Between budget year 2001-02 and 2005-06 the HWI initiative was funded internally by 'ATO base funding' (Joint Committee of Public Account and Audit 2001, p. 93). The HWI initiative still exists in the ATO but not as a 'taskforce'; it is a new business line called "Private Groups and High Wealth Individuals" (Australian Taxation Office 2014).

examining how it was transferred to other jurisdictions. The analysis in this chapter suggests that before a policy transfer, the following elements need to be examined:

- taxpaying culture and the values of the population, particularly as they relate to taxpaying;
- the principles that are proclaimed to guide the policy and its specific goals;
- any frameworks that integrate and give meaning to the principles and goals;
- the mechanisms that allow the authority to turn the principles and goals into successful actions; and
- the actors and stakeholders that are on board and contribute to successful policy implementation.

In May 2009, Indonesia's tax authority (DGT) decided to add a HWI initiative to its tax administration and looked to its equivalent in a neighbouring country, the ATO, to learn more about how it was done.

In the next chapter, the Indonesian tax system, its characteristics, and the challenges it faces are described. This is background to my investigation of the processes of policy transfer and implementation of the HWI initiative to Indonesia.

# Chapter 5

## The Indonesian Tax System and the Transfer of a HWI Initiative

*Compared to Australia, Great Britain and the United States, Indonesia chose to form its HWI office ... earlier in the maturation of its tax administration system.*

(RI040, international organisation)

*Organisations tend to model themselves after similar organizations in their field that they perceive to be more legitimate or successful.*

(DiMaggio & Powell 1983, p. 152)

### **Introduction**

Policy transfer involves a policy being adopted in one country after observing its operation in others. In the previous chapter I analysed the development and operation of the HWI Taskforce in Australia, widely regarded as a benchmark for policy implementation in this area. The analysis revealed a taxpaying culture that was committed to ensuring everyone complied with their legal obligations and the promotion of a tax system with which taxpayers would willingly cooperate. The HWI Taskforce was supported by this culture, an overarching compliance model framework,

principles of service, accountability and the *Taxpayers' Charter*, mechanisms of data linking and matching, priority setting and coordination across the ATO to focus on HWI cases, risk leveraging and networks of actors inside and outside government.

HWI initiatives have been adopted by tax authorities in 17 countries because the growth in HWI numbers presents tax authorities with similar challenges, including the risks to revenue and to the overall integrity of the tax system (OECD 2009a). The globalised economy, in which capital flows more freely across jurisdictions, has contributed to the rise of these challenges. In the Asia-Pacific region, Indonesia, together with Australia, China, New Zealand, and Thailand, are experiencing high growth in their HWI populations (Capgemini & RBC Wealth Management 2013, p. 6). Given that tax authorities face similar challenges from HWI taxpayers, they regard the transfer of policies that have proven successful elsewhere as a useful means of dealing with the problem. Nevertheless, proponents of the transfer need to be mindful of how to minimise the risks of failure associated with the implementation of the policy in a new environment.

The aims in this chapter are threefold. The first part of the chapter provides an overview of Indonesia's tax system and revenue needs for the state budget that led to the adoption of an HWI policy.

The second part of this chapter describes the policy transfer of the HWI initiative in Indonesia. Establishing the occurrence of policy transfer in the development of an HWI policy in Indonesia is the first step to explaining policy outcomes. Explaining what causes transfer and how the policy is transferred lead to a better understanding of the implementation process and its success or otherwise.

In the third part of the chapter I examine the design of the transfer in detail. This section covers elements of coercion and voluntariness in Indonesia's adoption of HWI policy, and reveals the expectations of government and senior officials at the strategic level of the organisation to bring into being a modern tax administration.

The last part of the chapter describes the failure of HWI policy in Indonesia from a programmatic perspective. In this section I answer such questions as: Did the policy achieve its intended outcomes? Was the policy an efficient use of resources? Was the policy made operational in a way that was consistent with achieving its objectives?

## **5.1 Overview of Indonesia's tax system**

Despite contributing almost 70 per cent of revenue to the state budget (Government of Indonesia 2012), the Indonesian tax system experiences low tax compliance levels. Indonesia's low level of tax compliance is reflected by its low tax-to-GDP ratio compared with other countries with a similar level of economic development or other countries in the same region. This, to some extent, indicates the existence of two major problems: substantial informality in the economy (cash or black economy)<sup>52</sup> and tax evasion<sup>53</sup> (OECD 2012a).

The widespread nature of the cash economy in Indonesia is indicated by the low level of registered taxpayers compared to estimated potential registration. Widespread tax

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<sup>52</sup> The notion of informality includes the concepts of both informal enterprises and informal employment (Swaminathan 1991, p. 29) and refers to: '... economic activities and transactions that are sufficiently hidden so that they are unmeasured or untaxed, and it is presumed that economic agents are at least passively aware that bringing these activities to the attention of authorities would imply tax or other legal consequences' (Andrews et al. 2011, p. 3).

<sup>53</sup> The term tax evasion is used to refer to: '...an act in contravention of the law whereby a person who derives a taxable income either pays no tax or pays less tax than he would otherwise be bound to pay. Tax evasion includes *the failure to make a return of taxable income* or the failure to disclose in a return the true amount of income derived' (Commonwealth of Australia 1975, para. 11.1, emphasis is added).

evasion is indicated by the low level of filed tax returns from registered taxpayers and a high ‘tax gap’<sup>54</sup>. These challenges, combined with demand to collect a huge amount of money for the state budget, have made achieving revenue targets the primary orientation of the Indonesian tax system (Rizal 2011). This section addresses these issues in detail. They are likely to be shared by other developing countries and inevitably have a major effect on tax policy and administration. The next section (section 5.1) opens with a discussion of why Indonesia’s tax system is known as a ‘target system’ (Lerche 1980), and concludes with a description of the organisational structure of Indonesia’s tax authority. Just as the basic features of Australia’s tax system and tax authority influenced how the HWI Taskforce functioned (see Chapter 4), basic features of Indonesia’s tax system and tax authority influenced how a HWI unit within DGT was likely to function.

### **5.1.1 Why Indonesia’s tax system is known as a ‘target system’**

Generating enough resources to fund development in order to reduce poverty and to provide basic public services is a common challenge faced by governments everywhere. But the challenge is greater in developing countries, such as Indonesia, where the government’s ability to generate revenue is relatively limited. Taxes have been the main source of government revenue for Indonesia since revenue from oil and gas began to decline in the mid-1980s (UNDP 2013, p. 68); the country’s first major tax reform occurred in this period (Asher 1998; Gillis 1990; Lerche 1986). Although the proportion of tax revenue to GDP in Indonesia is still low compared to that of other countries in the same region, tax revenue has contributed a significant portion of Indonesia’s domestic

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<sup>54</sup> The Tax gap references to difference between the amount of tax revenue that should have been collected and the amount of tax revenue that was actually collected (Brondolo et al. 2008, p. 16)

revenue in the last decade, on average 70.3 per cent of total domestic revenue (Table 5.1).

Increasing revenue for the State budget has led the Indonesian government to reform its national tax system with particular attention to ‘revenue enhancement’ (Das-Gupta & Mookherjee 1998, pp. 416–417; Gillis 1990b, p. 236). Malcolm Gillis observed that although the main focus of Indonesia’s first tax reform in the early 1980s was initially to address inefficiencies of the tax system, by the end it shifted toward raising revenue (Gillis 1989, pp. 94–95).

**Table 5.1 Indonesia: Domestic Revenue (2002–2011)**

Fiscal Year <sup>1</sup>	Tax <sup>2</sup>		Non Tax <sup>3</sup>		Total	
	billion (Rp)	(%)	billion (Rp)	(%)	billion (Rp)	(%)
2002	210.1	70.4	88.4	29.6	298.5	100.0
2003	242.0	71.0	98.9	29.0	340.9	100.0
2004	280.6	69.6	122.5	30.4	403.1	100.0
2005	347.0	70.3	146.9	29.7	493.9	100.0
2006	409.2	64.3	227.0	35.7	636.2	100.0
2007	491.0	69.5	215.1	30.5	706.1	100.0
2008	658.7	67.3	320.6	32.7	979.3	100.0
2009	619.9	73.2	227.2	26.8	847.1	100.0
2010	723.3	72.9	268.9	27.1	992.2	100.0
2011	873.9	72.5	331.5	27.5	1,205.4	100.0
Average	485.6	70.3	204.7	29.7	690.3	100.0

Source: Indonesia State Budget (various years), Indonesia MoF.

Note:

<sup>1</sup> Data for 2012 and 2013 are not included because they have not been audited.

<sup>2</sup> Tax revenues include domestic tax revenues (i.e., income tax on oil and gas, personal income tax (PIT) and corporate income tax (CIT), value-added tax, land and building tax, duties on land and building transfer, excises, and stamp duties), and international trade tax (i.e., import duties and export duties)

<sup>3</sup> Non-tax revenues include income from natural resources (i.e., oil and gas, general mining, forestry, fishery, and geothermal), profit transfer from state-owned enterprises, and other non-tax revenues collected by government agencies (e.g., license fees, fines, service charges).

In response to the Asian economic crisis in 1997, the Indonesian government again initiated tax reform. Tax administration reform in the early 2000s was regarded as successful in terms of achieving revenue targets, but not in terms of improving tax

compliance (Rizal 2006, p.187). Low levels of tax compliance have always been an issue for the Indonesian tax system, but the appetite for reform has always been directed to tax revenue (Asher 1998, p. 138). Lerche (1980, p. 50) referred to the prevailing tax system in Indonesia as a target system; that is, a tax system in which the achievement of revenue targets, that have been determined through a top-down process, is the ultimate goal. He observed that in the context of Indonesia's tax administration system, the revenue target is more political in nature than a financial statement to guide revenue forecasting and budget decisions. As political targets, Lerche argued, tax revenue targets are fixed revenue quotas which the responsible tax administration unit (regional tax offices and tax service offices) is required to collect by all possible means. Tax officials' performance relative to the target attracts sanctions or rewards (Lerche 1980, p. 50). The use of revenue achievement as the main indicator of success in the Indonesian tax administration, as we shall see later, has significant impact on how high level officials saw or judged the success of the HWI unit.

What Lerche observed more than three decades ago is still relevant in Indonesia today, in that the targeted tax system works from the top down. Basically, it means that the global revenue target that DGT has to achieve in a particular fiscal year 'is not the sum of regional sub-targets developed from the grass roots up' (Lerche 1980, p. 50). Targets are cascaded down to individual officials or even taxpayers (p. 51). For example, if a regional tax office (*kantor wilayah* or *kanwil*) is given a target of 3.5 trillion Rupiah, the target will percolate down to the TSOs (*kantor pelayanan pajak – KPP*) under its supervision.

Suppose a TSO receives a 750 billion Rupiah revenue target. This target will be cascaded to sections within that TSO, especially consultation and monitoring sections,

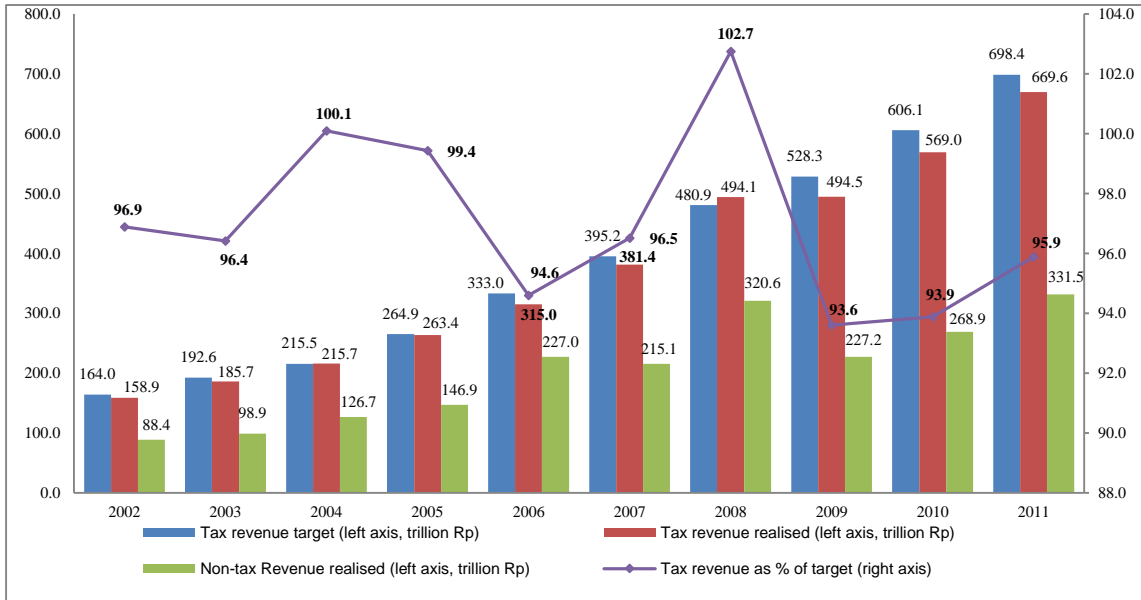


and then within each section the target will be divided among individual account representatives responsible for looking after certain taxpayers. Targets are rarely based on tax capacity data for specific groups of taxpayers, regions or administrative units, as Lerche observed, but rather on the previous year's achievement with a plus or minus adjustment (the adjustment is due to incremental changes in the revenue target from headquarters). Moreover, according to Lerche (1980), the ultimate function of the target system is 'to serve as a yardstick for appraising the performance of tax officials and of regional or [tax service] ... units of the tax administration' (p. 50). Revenue targets are one source of pressure not only for high level officials such as a *kanwil* chief, but also for lower-level officials such as a *KPP* chief, section heads, or account representatives.

Tax targets are politically sensitive within DGT in that failure to meet them attracts sanctions. Delayed promotion, deployment to a lower-grade position, or transfer to less favored places (e.g., remote regions or islands across Indonesia) are sanctions that chiefs of units (e.g., *kanwil* and *KPP*) and even lower-level staff (e.g., section heads) may face when a revenue target is not achieved. Lerche observed that: 'Loss of face or prestige may be penalties for non-fulfillment [of revenue targets] sufficient to motivate tax officials' (p. 51). At the same time, sanctions are also the main source of pressure and frustration for officials at the ground level and a source of tension between headquarter and operational units. An Indonesian MoF decree governing transfer of staff within MoF stated that the performance of a *KPP* chief is measured in terms of his/her ability to achieve revenue targets (Indonesia Ministry of Finance 2009, chap. II).

Lerche (1980) argued that focusing attention on the achievement of revenue targets as the main measure of the tax administration's performance would adversely affect Indonesia's tax system and tax compliance in the long term (see Brondolo et al. (2008)

for a more recent study). The targeted revenue in the state budget has remained unrealised in most years in the last decade (Figure 5.1), on average falling short by four percentage points.



**Figure 5.1 Indonesia: tax and non-tax revenue against targets (2002-2011)**

Source: Indonesia State Budget (various years)

Indonesia’s ability to generate tax revenue remains noticeably lower than that of other countries in the region. On average, Indonesia’s tax-to-GDP ratio (and indicator used to measure the government’s performance in generating tax from domestic economic activities) during the period 2003-2011 was 10.8 per cent, lower than the average of 15.9 per cent for non-OECD countries in the region and much lower than the average of 28.7 per cent of tax-to-GDP ratio of OECD countries in the region (Table 5.2). In short, Indonesia’s tax-to-GDP ratio is ‘one of the lowest in the G-20 and among emerging countries’ (IMF 2011b, p. 20).

**Table 5.2 Tax Revenue of Selected Asia-Pacific Countries, 2003-2011 (as percentage of GDP)**

	2003	2004	2005	2006	2007	2008	2009	2010	2011
<b>Indonesia</b>	10.7	11.2	11.2	11.0	11.3	10.2	10.2	10.6	10.8
Average all countries	19.2	19.5	19.8	20.1	20.4	20.0	19.2	19.4	19.9
<b>Selected OECD</b>									
Australia	30.0	30.3	30.0	29.6	29.7	27.1	25.8	25.6	26.5
Japan	25.3	26.1	27.3	28.1	28.5	28.5	27.0	27.6	28.6
Korea	24.0	23.3	24.0	25.0	26.5	26.5	25.5	25.1	25.9
New Zealand	33.7	34.8	36.6	36.0	34.7	33.8	31.6	31.5	31.5
Unweighted Average	28.2	28.6	29.5	29.7	29.8	29.0	27.5	27.5	28.1
<b>Asia Pacific (non-OECD)</b>									
China	17.1	17.6	15.6	16.1	17.2	17.3	17.5	18.2	19.0
Hong Kong	10.4	12.1	12.7	12.8	14.2	13.0	12.8	13.9	14.2
Malaysia	16.5	15.3	15.4	15.1	14.8	15.2	15.7	14.3	15.3
Philippines	12.8	12.4	13.0	14.3	14.0	14.2	12.8	12.8	12.3
Singapore	12.9	13.0	12.5	12.7	14.2	14.3	13.2	12.9	13.7
Thailand	16.0	16.6	16.3	16.2	16.0	14.9	15.8	16.9	16.9
Vietnam	20.9	21.7	22.8	24.3	23.5	24.4	22.3	23.6	24.1
Unweighted Average	15.2	15.5	15.5	15.9	16.3	16.2	15.7	16.1	16.5

Source: Revenue statistics 1965-2011 (OECD 2012b); IMF country report (various years, various country)

Terra and Hudson (2004, p. 786) identified a set of factors that determine a tax authority's ability to maximise tax potential and attain targets: the country's economic structure, level of development, administrative and political constraints on the fiscal system, social-political values, and indigenous institutional arrangements. These factors, according to Terra and Hudson, interact in different ways at different times in different countries, resulting in disparities in tax collection performance. Indonesia's low tax-to-GDP ratio therefore may reflect inherent weakness in the tax collection infrastructure: poor design of the tax system, weak tax administration, and low social commitment to taxpaying.

### 5.1.2 Problems experienced by Indonesia's tax system

Indonesia's low tax burden and high non-compliance is well recognised. In this section the three indicators of low taxpaying commitment among Indonesians are discussed: low registration, non-filing among those registered, and the tax gap.

#### *Low proportion of registered individual taxpayers and its consequences*

The first major administrative hurdle faced by the DGT is to bring citizens into the tax system through a registration process. The small proportion of individual taxpayers on the tax register means that the country has a heavy reliance on corporations as the main source of tax revenue for achieving revenue targets.

In 2011 the total number of registered taxpayers<sup>55</sup> was 19.11 million, consisting of 16.88 million individual taxpayers, 1.76 million corporate taxpayers, and 0.47 million treasurer taxpayers.<sup>56</sup> The total work-force<sup>57</sup> population was 116.38 million in 2011 (World Bank 2012); thus, only 14.50 per cent of the workforce are registered individual taxpayers. Marks' (2003) research, based on Indonesia's 2002 National Socioeconomic Survey (*Susenas*) data, found that 63.1 million people should be registered in the system as individual taxpayers – almost four times the existing number. On the positive side,

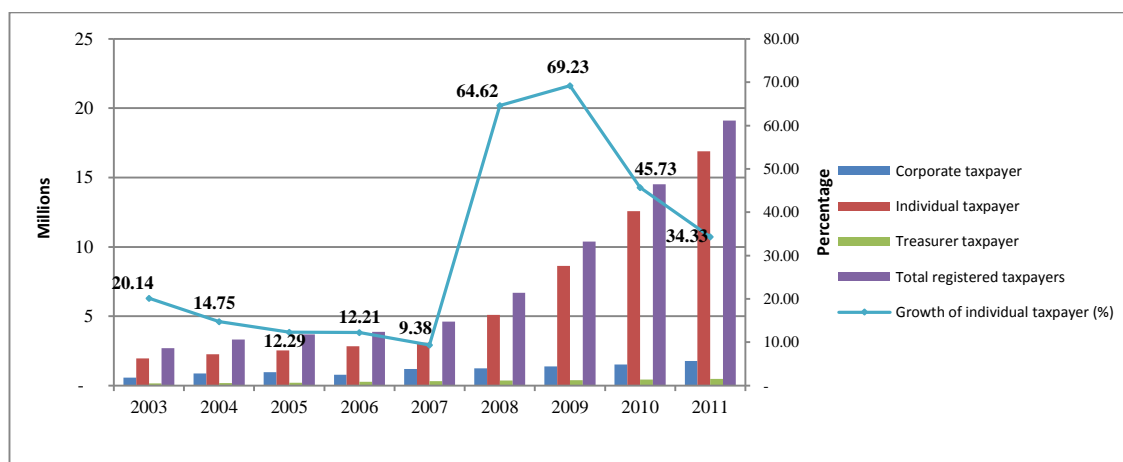
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<sup>55</sup> The Indonesian tax authority categorises taxpayers into three groups: individual, legal entities, and treasurer taxpayers. While individual and entities taxpayers are obliged to file a tax return, the treasurer taxpayers are not obliged to file annual tax returns. Treasurer taxpayers are treasurers in government agencies whose role is administering financial matters of the agency, and in the taxation context their role is mainly as withholding agents for taxes such as salary and wages and VAT. The number of taxpayers in the last category is 0.47 million.

<sup>56</sup> Legal entity taxpayers include enterprises (including SOEs), firms, cooperatives, foundations, mass organisations, partnerships, and political organisations.

<sup>57</sup> The total labour force comprises people aged 15 and older who meet the International Labour Organization (ILO) definition of the economically active population: all people who supply labour for the production of goods and services during a specified period (World Bank, 2012).

Figure 5.2 does show a five-fold increase in the number of registered individual taxpayers in four years between 2007-2011.



**Figure 5.2 Indonesia: the growth of registered taxpayers (2002-2011)**

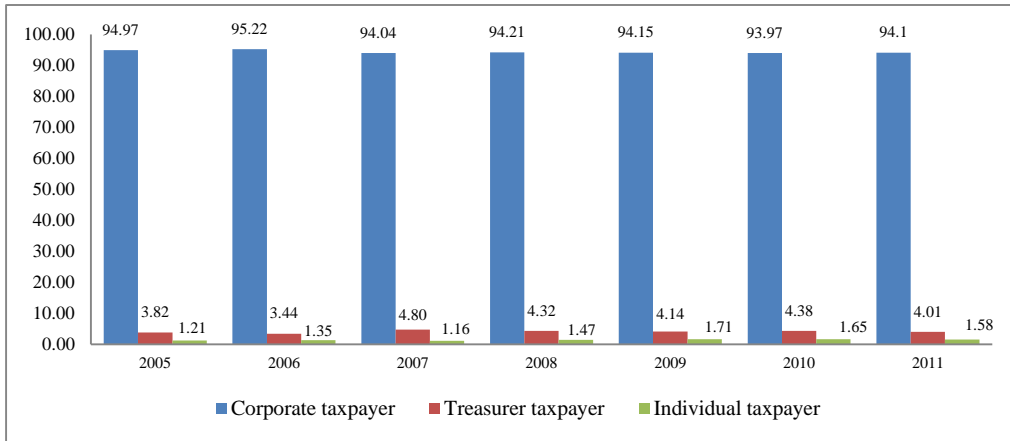
Source: Directorate of Potential, Compliance and Revenue (2012)

Note: The percentage of unregistered taxpayers would be very helpful in depicting the depth of the problem in Indonesia's tax administration. However, such information is not available.

While the number of individual taxpayers outnumbers corporate taxpayers, Indonesian tax revenues rely heavily on taxes derived from corporations which comprise almost 95 per cent of total taxes revenue (Figure 5.3).<sup>58</sup> Reliance on revenue from corporate income tax was an issue of concern to the Ministry of Finance when the GFC occurred in September 2008. Most of Indonesia's big corporations were integrated into the global market, and profits dropped accordingly, and they were the major contributors to

<sup>58</sup> Indonesia's tax administration classifies tax revenues not only based on who is the bearer of the tax but who pays the tax money into the Government's account. So, for example taxes with respect to salary and wages, are withheld by the employer (e.g., corporation, government agencies), although in reality they are personal income tax, i.e. the ultimate bearer of the tax is the employee (personal). Yet this tax is classified under the classification of 'income tax generated from corporation' rather than under the classification of 'personal income tax'. There is no sufficient data available to accurately provide the amount of 'corporate income tax' paid as opposed to 'income tax generated from corporation'. Similarly, it is impossible to put figure on 'personal income tax' as opposed to 'income tax generated from personal taxpayers': '... a direct break-up of income tax into personal and corporate income tax is not available in Indonesia' (Francis 2012, p. 17). The IMF uses prediction to split personal income tax and corporate income tax for Indonesian data (IMF 2011a).

income tax. Indonesia's tax revenue plummeted at a time that it needed a fiscal stimulus. This, as shown later, was one factor that contributed to the decision to adopt the HWI initiative.



**Figure 5.3 Indonesia: tax revenue contributions per taxpayer category, 2005-2011 (as percentage of total revenue)**

Source: Directorate of Potential, Compliance and Revenue (2012)

Relying on corporations as the dominant contributors to domestic revenue is a common phenomenon in developing countries (see Arnold (2012) for Indonesia; and Bird and Zolt (2004) for other developing countries). Among OECD countries, the average share of corporate tax from 1965-2010 was 8.8 per cent (OECD 2012b). The OECD countries with the highest proportions of personal income tax to total tax revenue are Denmark, New Zealand, and Australia, with 51.8, 45.2, and 39.5 per cent respectively.

The main reason why corporate taxpayers play such an important role in the Indonesian tax system, and why the DGT devotes so much of its resources to this taxpaying group, was that the DGT sees more potential in focusing on corporate taxpayers in terms of securing tax revenue and meeting targets (RI002, tax official). As discussed earlier,

meeting targets is a priority for operational units wary of headquarters' judgements on their performance. One respondent illustrated this by saying that:

... the policy from our headquarters is driven by their revenue orientation; therefore strategies chosen [on the ground] are more on monitoring the corporate taxpayer [than individual taxpayers] ...' (RI013, tax official).

A preference for dealing with corporate taxpayers was a common theme among respondents representing tax officials as a group. One respondent, formerly a high-echelon official, said that:

You can get Rp100 billion from only one corporate taxpayer, whereas you will need more than 100,000 individual taxpayers to only get Rp1 billion. (RI030, former tax official).

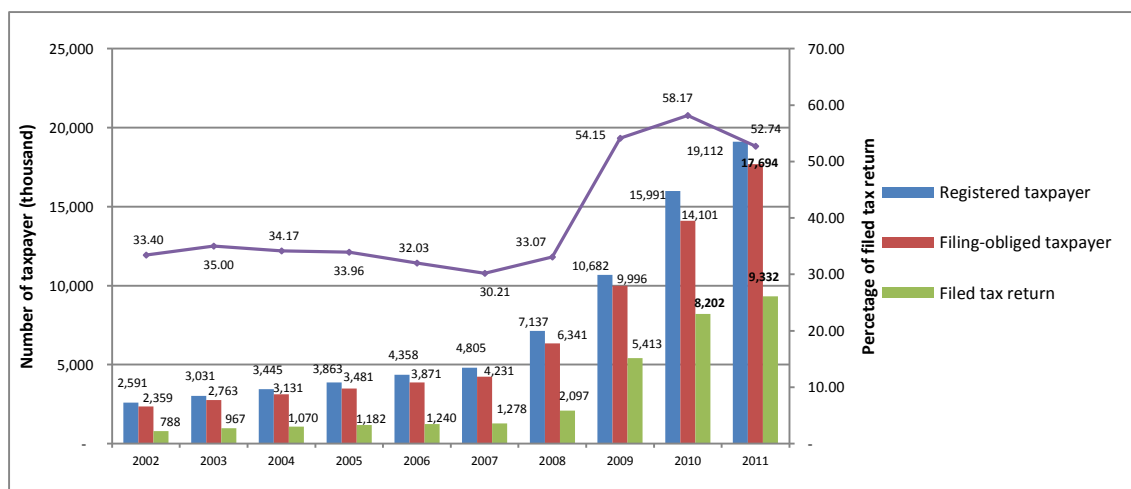
A tax consultant and academic interviewed for this study criticised this way of thinking, describing the strategy as 'looking for something that gives the greatest probability of a win' (RI031, tax consultant). Nevertheless, Indonesian tax officials prefer to deal with a small number of taxpayers who contribute much, rather than with a huge number of taxpayers who contribute less to the tax revenue. Ultimately, the basis for measuring their performance is achieving a revenue target. This is not to say, however, that no other key performance indicators are used for measuring a unit's performance, but reaching the target dominates the thinking of officials on the ground, derived from the policy from headquarters.

The low rate of registration among individual taxpayers also signifies the substantial proportion of 'shadow economy' activity in Indonesia. Schneider and Bajada (2003) studied 18 countries in the Asia-Pacific region over a 10-year period (1990-2000) and found that the size of the shadow economy and its labour force are much higher in

developing economies than in more developed ones. They found that Indonesia's informal labour force was 31.3 per cent of the size of the 'official' labour force (the second largest in the study, below only Thailand with 40 per cent), and well above the 22 per cent average of the studied countries (Schneider & Bajada 2003, p. 25). This may explain why the proportion of registered individual taxpayers in Indonesia is so low (less than 15 per cent of the workforce population based on the World Bank's 2011 workforce data) (World Bank 2012)

*Low compliance in filing tax returns: A form of disengagement with the system*

Not filing a tax return that is required by law is the most obvious form of tax evasion. The annual compliance rate (income tax returns filed as a proportion of taxpayers required to do) has been less than 60 per cent in the last ten years (Figure 5.4).



**Figure 5.4 Indonesia: filing tax return compliance rate (2002-2011)**

Source: Directorate of Potential, Compliance and Revenue (2012)

Note: The purple line indicates filed tax return as a percentage of filing-obliged taxpayers.

Apart from a deeper obligation to report correct amounts of income and to pay correct amounts of taxes, filing a tax return is the principal obligation of a registered taxpayer.



Failing to commit to this principal tax obligation may reflect a form of disengagement from the system<sup>59</sup> (Braithwaite 1995; Braithwaite et al. 1994; Braithwaite et al. 2007), or alternatively a belief among Indonesians that tax officials do not care about filing from individual taxpayers when corporate taxpayers are likely to make a greater contribution to the revenue target. Either way, the attitude is one of paying little attention to tax obligations and treating such obligations dismissively.

Tax rules for individual taxpayers have not been developed, the focus has always been on corporate taxpayer ... the individual taxpayer has not been managed seriously. (RI024, tax official)

Consistent with this interpretation of disengagement and dismissiveness are comments from respondents who were very conscious of Indonesian cynicism about the power of government and detected the psychological separation in Braithwaite and Braithwaite's (2001, p. 411) description of taxpayers' motivational posturing: '[a] wall has been constructed between the regulated and the regulator'. One tax official told his story about how difficult it was to meet his designated wealthy taxpayers, even just to introduce himself (and his team) as a client contact point:

It's really hard to meet them [HWIs] directly; at the very best we could only meet their confidants, or at least their tax consultants (RI002, tax official)

I think they have had bad perceptions of the tax office. They could not believe it when we came [to introduce ourselves]. I just met with their confidants. They have built up relational distance with us [as tax officers] and the tax office. Our task, in my opinion, is

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<sup>59</sup> Disengagement with the tax system refers to an outlook not caring about doing the right thing by the tax authority and believing the tax authority cannot do anything to them if they choose not to comply with tax laws (Braithwaite 2009; Murphy 2002).

working out how to change the bad perceptions that already have existed in the minds of the public regarding tax officials and DGT as an institution. (RI022, tax official)

There were taxpayers who had had unpleasant experiences of dealing with the tax office; it is hard [to be resolved] ... their hurt feelings are still there. (RI024, tax official)

Long-held negative perceptions stem from the days when the tax system, DGT, and tax officials were widely known to be corrupt and coercive, prior to tax reforms in 1983 (Toye & Moore 1998) and in the early 2000s (Rizal 2011). In an ‘Innovation for Successful Societies’ interview, a former director of the DGT noted that corrupt practices were the main problem that the DGT had to deal with in the past (Schalkwyk, 2009, p. 2).

One respondent reflected this by saying that it was very challenging to build a relationship with taxpayers who were traumatised by their experiences with the tax office (RI024, tax official). One taxpayer’s confidant described how, in the past, dealing with a tax official meant one must be ready to be extorted (RI038, taxpayer’s representative). This made the taxpayers wary, even when communication with tax officials was over a simple matter like lodging a tax return.

### *The width of the tax gap*

As noted earlier, the tax gap refers to the difference between the amount of tax revenue that should have been collected and the amount of tax revenue that was actually collected (Brondolo et al. 2008). Most tax authorities examine their tax gap, with the goal of understanding which tax-related activities contribute most to it. Tax policy strategy is then directed at narrowing the tax gap. By measuring and tracking compliance over time through the tax gap, tax authorities are able to identify the

magnitude of non-compliance in different areas, as well as evaluate the effectiveness of strategies used to address these areas of non-compliance (HM Revenue & Customs 2005; OECD 2001a). The DGT has not yet undertaken a systematic study to estimate the magnitude of the tax gap. The only known research on the tax gap in Indonesia to date was conducted by Marks (2003). Marks' survey suggested that personal income tax revenue amounted to only 43 per cent of potential revenue.

An alternative way to understand a country's tax performance is by measuring its 'tax effort' (Stotsky & WoldeMariam 1997, p. 10). Tax effort refers to the ratio between the share of GDP and predicted taxable capacity. Taxable capacity refers to predicted tax-to-GDP ratio, by taking into account a country's specific macroeconomic, demographic, and institutional features (Le et al. 2012, p. 1). A country with a tax effort index above 1 is regarded as a high tax effort country, meaning that the country utilises its tax base to increase tax revenue effectively (Stotsky & WoldeMariam 1997, p. 5). In contrast, a country with a tax effort index below 1 is categorised as a low tax effort country, meaning that the country has substantial potential to generate tax revenues that have not been developed.

Le et al. (2012) conducted research using data from 110 developing and developed economies during 1994-2009 and categorised countries into four groups based on their tax efforts and tax collections (Table 5.3)<sup>60</sup>: low tax collection, low tax effort; high tax collection, high tax effort; low tax collection, high tax effort; and high tax collection, low tax effort (p. 21). According to this study, Indonesia is among the low tax

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<sup>60</sup> Le et al (2012) in this study used the value of one as the dividing point between high and low for the tax effort index and 18.31 % (median of the tax-to-GDP ratio in the sample of the study) for actual tax revenues. A country is regarded as a low-collection country if its actual collection is lower than 18.31 per cent, and regarded as a high-collection country if its collection is above this level (p. 1).

collection, low tax effort countries, which means that despite relatively substantial opportunity to collect tax, Indonesia still struggles in utilising its tax base to increase revenue.

In summary, despite inherent problems faced by the Indonesian tax system discussed above, data presented from previous research indicated there is a potential for Indonesia's tax revenue that can be explored: unregistered personal taxpayers, informal economy, and tax gap. In order to ensure that tax collections are performing efficiently, it is essential to have an effective tax administration system (Alink & van Kommer 2011). One of the elements of a tax administration system is a tax authority which is responsible to administer tax law and regulation. The next chapter discusses Indonesia's tax authority: the Directorate General of Taxation (DGT).

**Table 5.3 Classification of Countries Based on Tax Efforts and Tax Collection (1994-2009)**

		TAX EFFORT						
		LOW			HIGH			
TAX COLLECTION	LOW	Developing Countries			Developed Countries	Developing Countries		Developed Countries
			Albania	Dominican Rep.	Oman	Canada	Bolivia	
		Argentina	Egypt, Arab Rep.	Panama	Japan	Cote d'Ivoire		
		Armenia	Peru	Paraguay	Korea, Rep. United States	Ghana		
		Azerbaijan	Philippines	Peru		Honduras		
		Bahamas, The	Senegal	Sierra Leone		Kenya		
		Bahrain	Sierra Leone	Sierra Leone		Mali		
		Bangladesh	Sierra Leone	Sierra Leone		Nicaragua		
		Burkina Faso	Sudan	Sudan		Pakistan		
		Cameroon	Thailand	Thailand		Sri Lanka		
		China	Uganda	Uganda		Syrian Arab Republic		
		Colombia	Yemen, Rep.	Yemen, Rep.		Togo		
		Congo, Dem. Rep.	Madagascar	Madagascar		Zambia		
		Congo, Rep.	Malaysia	Malaysia				
			Mexico	Mexico				
HIGH	Developing Countries	Developed Countries	Developing Countries	Developed Countries	Developing Countries	Developed Countries	Developing Countries	Developed Countries
	Bulgaria	Czech Republic	Belarus	New Zealand	Australia			
	Estonia	Denmark	Botswana	Zealand	Austria			
	Jordan	Germany	Brazil	Papua New Guinea	Belgium			
	Latvia	Iceland	Chile	New Guinea	Cyprus			
	Moldova	Ireland	Costa Rica	Poland	Finland			
	Romania	Luxembourg	Croatia	Slovenia	France			
	Russian Federation	Spain	Hungary	South Africa	Greece			
	Slovak Republic	Sweden	Jamaica	Africa	Italy			
	Turkey	Switzerland	Mongolia	Trinidad and Tobago	Malta			
	Turkey		Morocco	Tunisia	Netherlands			
	Ukraine		Namibia	Uruguay	Norway			
				Vietnam	Portugal			
				Zimbabwe	United Kingdom			

Source: Le et al. (2012, p. 24)

### 5.1.3 Organisational structure of the Directorate General of Taxation (DGT)

The institutional characteristics of the organisation responsible for a policy or program obviously affect policy implementation. Indonesia's HWI unit operated within Indonesia's tax authority, the DGT. The DGT is one of the 11 echelon I units within the Indonesian MoF portfolio (others include the Directorate General of Customs and Excise, the Fiscal Policy Agency, and the Directorate General of Treasury).

The DGT is the biggest echelon I unit within the MoF. It is similar in size to the bigger units in other ministries in the Indonesian government. It is big not only in terms of the number of its employees compared to other echelon I units in the Indonesian ministries, but in terms of its geographical jurisdiction. With 31,736 employees in 2011 (Directorate General of Taxes 2012), it accounts for almost 50 per cent of the MoF workforce (68,696 people) (Indonesia Ministry of Finance 2014). The DGT's operational offices are located in almost all provinces, cities, and municipalities in Indonesia. The archipelagic nature of Indonesia, with nearly a thousand inhabited islands (UNDP 2013, p. 51), makes this geographical dispersion extraordinary, with profound consequences for administrative coordination and cooperation. Table 5.4 illustrates the type and number of DGT operational offices in Indonesia.<sup>61</sup>

As a central government agency, DGT is responsible for administering central government taxes that include income tax for both corporate and individual taxpayers,

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<sup>61</sup> As of 31 December 2012 there were 34 provinces, 97 cities, and 415 municipalities in Indonesia. There are no other echelon I units within the Indonesian government's ministry offices that have operational units covering also many regions of Indonesia.

VAT, and stamp duty.<sup>62</sup> Previously DGT also administered land and property taxes and land and property acquisition duties. The former were handed over to local governments in 2011, whereas the latter are being gradually handed over to local governments, starting in 2011 with an expected end date of 2014.

**Table 5.4 Types and Number of Operational Offices within DGT (as of 31 December 2011)**

Type of office	Number of offices
Regional office	31
Large taxpayers tax service office (LTO)	4
Medium taxpayers tax service office (MTO)	28
Small taxpayers tax service office (STO)	299
Counselling and consultation office (CCO)	207
Technical supporting unit	3

Source: DGT (2012)

Structurally, DGT is divided into policy-making and operational functions. Policy-making functions are carried out at the DGT's headquarters in Jakarta. In general, the main role of headquarters is formulating programs and strategies, and supervising the operational units' program implementation. Headquarters has the power to evaluate the operational units' performance in terms of their revenue target achievement and make decisions on rewards and punishments.

At the operational level there are three kinds of unit: regional offices, TSO, and CCO.

Regional offices (*kanwil*) are responsible for coordinating, supervising, and evaluating

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<sup>62</sup> Sub-national governments (provinces, cities, and municipalities) have the right to collect revenue from excises, duties or licence fees other than income taxes, VAT and stamp duty, which may include: business licence fees, restaurant and entertainment tax, advertisement excises, building permit excises, vehicle ownership duty, land and building taxes, and land and building acquisition duty.

TSOs' performances under its supervision. *Kanwil* have authority to elucidate headquarters' programs to make them more applicable to the local context. A *kanwil* is an echelon II unit. While formally a *kanwil* is an operational level office, similar to TSOs and CCOs, it is a higher-level echelon than TSOs (echelon III) and CCOs (echelon IV). As shown later, this influences the relationship between a *kanwil* and TSOs and CCOs. A *kanwil* is seen, and to some extent positions itself, at arm's length from headquarters. For instance, revenue targets are allocated by headquarters regionally, but a *kanwil* has authority to cascade the target down to the TSOs under its supervision. Another example is that although final decisions to deploy staff are made by headquarters, a *kanwil* has a right to suggest to headquarters which staff should be rotated. More importantly, a *kanwil* chief has authority to evaluate a KPP chief's performance, especially in terms of target achievement, and it is on the basis of this information that promotion or demotion is considered.

TSOs (*KPP*) function as DGT's front-liners in dealing with taxpayers. They are the first point of contact between taxpayers and DGT; they help taxpayers to register and lodge tax returns, provide advice and file objections (although the objection will be processed at regional office). *KPP* also has an audit function. This function is done by 'functional' staff, that is, tax auditors.<sup>63</sup> In order to support its function in remote areas, particularly in providing counseling and consultation, a KPP may have CCOs under its structure (not all *KPP* have CCOs under their structure, especially those located in big cities). A CCO chief is responsible to the TSO chief.

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<sup>63</sup> As opposed to 'structural' staff, the term used for positions that are regarded as not requiring the specialised expertise of tax auditors and tax investigators.



This structure is important for understanding the pressure on the HWI unit in Indonesia and its ability to coordinate with other parts of the DGT. The HWI tax service office in Indonesia is an echelon III unit, similar to the other 330 TSOs (*KPP*) in terms of echelon level, function, and authority. What distinguishes LTO, MTO, and STO is the type of taxpayers they serve. LTOs, in which the HWI unit is included, serve big corporations (three LTOs are dedicated to this function) and HWIs (one HWI unit serves this function).<sup>64</sup> All LTOs are structured under the Large Taxpayers Regional Office (LTRO), located in Jakarta. MTOs administer corporate taxpayers in one particular region; these corporations are not as big as those administered in LTOs. One regional office has one MTO under its supervision and several STOs, depending on the region's economic potential. Lastly, STOs administer individual taxpayers, small enterprises, and other legal entities (e.g., small enterprises, foundations, co-operatives, firms) and are located in almost all cities and municipalities in Indonesia.

Prior to the establishment of the HWI unit in 2009, all individual taxpayers were registered and administered in STOs (together with small enterprises), including those eventually categorised as HWIs. The very wealthy were mingled with general taxpayers, which made them feel 'uncomfortable' (RI016, tax ombudsman). However, as a pilot project, Indonesia's HWI unit was established to only administer HWIs who resided in Jakarta (Indonesia's capital). In other words, some other wealthy individuals who resided outside Jakarta were not yet included in the program.

Understanding DGT's organisational structure and how relationships are developed between different levels of the organisation helps explain the way in which the HWI

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<sup>64</sup> Before the HWI unit's function and name was changed in 2012.

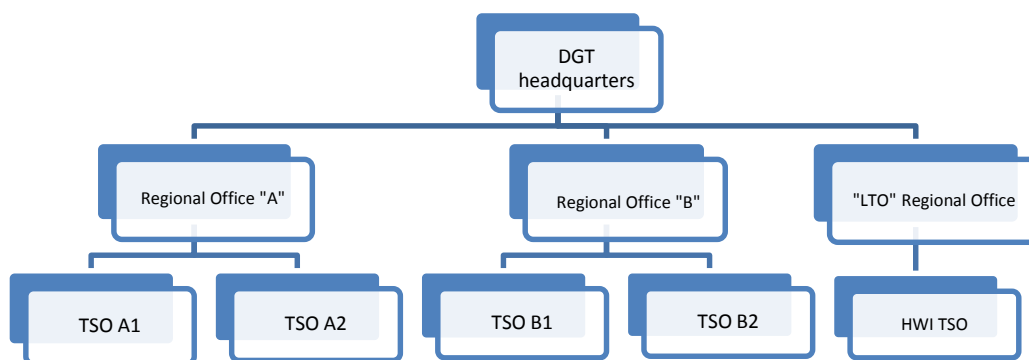
unit in Indonesia was implemented. Indonesia, according to Hofstede's (1997) cultural typology, is a country with a 'high power distance' culture, that is, a culture where 'the less powerful members of an institution and organization accept that power is distributed unequally' (Hofstede & Bond 1984, p.419), and where formality is an important characteristic of the culture (Sharma 2003). These characteristics are associated with high social inequality and one person (or institution or organisational unit) having authority and power over others (Hofstede & Bond 1984). These characteristics describe the structure of DGT in social terms. As discussed later, differences in organisational level determined the pattern of relationships that the HWI unit and its officials had with DGT headquarters, regional offices, other TSOs around Indonesia, and other government and non-government institutions that contributed to the HWI unit's performance.

#### **5.1.4 Organisational bottleneck in the DGT**

The organisational structure of the DGT was described in the previous sub-section. This structure is illustrated in a simplified diagram in Figure 5.5. It shows that the tax service office (TSO) or *KPP* is the lowest organisational unit within the DGT. When the HWI program was transferred to Indonesia, the organisational structure that was set up to accommodate the policy was a TSO – similar to existing TSOs, in terms of its structure, functions, and authorities.

When three senior DGT officials, accompanied by an IMF advisor, were sent to Australia in 2008 to learn how regulatory arrangements dedicated to wealthy taxpayers were set up, they realised that organisational structure was one of the challenges the DGT might face in adopting the regulatory model Indonesia was choosing (RI041, tax official). In Australia, the HWI program was run by a unit called the HWI Taskforce,

which was regarded as ‘a special high level task force’ (Costello 1996, p. 7). Overall leadership of the taskforce was undertaken by a First Assistant Commissioner in its first years of operation and then by an Assistant Commissioner.<sup>65</sup> This was considered as a high level structure, in that the position could represent the ATO in front of Senate committee hearings, for instance.<sup>66</sup>



**Figure 5.5 DGT organisational structure (simplified)**

A respondent in Australia suggested that a more authoritative power should be granted to an institutional arrangement such as the HWI unit due to the nature of its work. He asserted that dealing with HWI taxpayers is a ‘very sophisticated game’ and a ‘very complex game’ because ‘there will be a lot of stakeholders involved’ (RA003, tax official).

<sup>65</sup> In New Zealand the HWI unit of Inland Revenue is placed in headquarters within the corporate group division. In the US’s IRS, HWI initiative is called the Global High Wealth Industry group and is housed in the IRS’s Large Business and International Division in headquarters; in South Africa’s SARS, the unit is called High Net-Worth Individual Sector and is hosted within SARS’ Large Business Centre (LBC) in headquarters; and in the UK the unit is called High Net Worth Unit under its Charity, Asset & Resident division, also in headquarters. All of HWI units are at high-levels within their parent organisations.

<sup>66</sup> A Senate public hearing on 3 November 2003 (Parliament of Australia 2000) with respect to the HWI Taskforce was attended by HWI Taskforce personnel rather than the ATO Executive Committee; this was not only due to the specificity of the subject but also reflected the acknowledgement of the higher-level of the unit.

Internally, dealing with HWIs also means dealing with different parts of the organisation within DGT. The reason is because dealing with HWIs involves different types of companies, in terms of their size and their products/services. Generally speaking, HWIs structure their businesses in such a way that the money circulates only among their closely tied companies in order to accumulate wealth (Carroll 2000). Tax authorities, which design their organisational structure around different types of taxpayers: small enterprises, medium-sized businesses, large businesses, and private individuals (Alink & van Kommer 2011, p. 235), tend to conduct separate compliance programs throughout the business lines, without trying to get a holistic picture of related entities with the same individuals in control.

Tax administration that applies compliance programs based on taxpayers' size will be very likely to overlook high-risk transactions involving HWI-related entities that crossed over various business lines (OECD 2009a). In order to get a global view of the overall configuration of highly complex group structures, different parts of the organisation should be involved in HWI tasks such as taxpayer profiling, risk assessing or auditing that may include all linked entities. This mechanism, as discussed in Chapter 4, is considered an efficient way to deal with HWIs and has been practised in Australia since the HWI initiative was introduced, and since by other countries (e.g., New Zealand, South Africa and the US). This coordinating role is one of the important features of an HWI unit, and it can only be articulated by placing this unit in a high profile position within a tax administration structurally, such as is the case at the ATO.

Externally, dealing with HWI taxpayers also means dealing with stakeholders who have close relationships with taxpayers such as lawyers, accountants, tax consultants, investment advisers and other government and non-government agencies. With plentiful

financial resources on hand, wealthy taxpayers ‘have access to very smart lawyers and accountants’ (RA011, tax official) from whom they get advice on how to structure their business and how to manage their tax affairs. Therefore, it is also important for tax officials in the unit to have the same ‘level of confidence’ when dealing with this community.

Dealing with other government and non-government agencies about HWI taxpayers is needed to gather information and build data-bases. Data acquired from other institutions may be very useful when a tax authority is assessing compliance with tax regulations. These agencies include vehicle registration authorities, land and property registration authorities, corporate, market and financial services regulators and anti-money laundering regulators.

Given the fact that the operation of an HWI program involves various internal and external stakeholders, it is important for adopting countries such as Indonesia to learn what mechanisms should be applied in terms of organisational structure. Learning should include, for instance, whether or not that unit will be structurally constrained when dealing with other parts of the tax office and with other institutions. A high-profile organisational structure for the HWI unit will provide it with more authority and give confidence to the staff when dealing with high-end taxpayers and their advisers (see for instance OECD 2009, chap. 3; Alink & van Kommer 2011, pp. 278–281). Unfortunately, as described later, this was not the case in the Indonesian context.

Establishing an HWI unit in Indonesia at a similar structural level as in Australia is not a simple matter, since the organisational structure of the MoF (and other ministries) is strictly regulated by a presidential decree.<sup>67</sup> One respondent explained this situation:

They [the Australian Tax Office] have a taskforce, but what can we have here? Because of nomenclature constraint or anything else, to establish a [new] directorate [at the headquarters] or taskforce [an ad hoc structure] is impossible [due to limited time available]; therefore we established a tax service office. (RI009, tax official)

The time available in 2009 for DGT to propose a flagship program (under the ‘quick-win programs’ concept – see section 6.1) was very limited. Although organisational structure seems a simple matter, this results in important consequences in an Indonesian context. The vast majority of respondents from the HWI unit argued that the unit was similar to other TSOs, although its tasks were actually bigger. ‘Substantially’, one respondent said, ‘there is no significant difference with other tax service offices’ (RI027, tax official). What the respondent meant was that the unit’s power was similar to that of other TSOs. That is, because the HWI unit was an echelon III level unit, like other TSOs, it faced ‘structural challenges’ (RI041, tax official) when dealing with other units at a similar level, let alone at higher levels.

### *Dealing with taxpayers*

When dealing with HWI taxpayers, whose wealth and ‘social capital’ (see for instance Bourdieu 1986 for different kinds of capital) made them formidable opponents, HWI

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<sup>67</sup> President decree number 47 of 2009 determines the maximum number of directorates in one directorate general. If the DGT wanted to adopt an organisational structure for the HWI Taskforce such as that in the ATO, then the unit should have been placed at its headquarters at least in echelon II (directorate). Changing the number of directorates in one directorate general is not a simple process, and the time available for DGT to establish the unit was very limited.

unit staff felt a ‘psychological barrier’ (RI002, tax official). Bourdieu (1986) defined the concept of social capital as ‘the aggregate of the actual or potential resources which are linked to possession of a durable network of more or less institutionalized relationships of mutual acquaintance or recognition’ (p. 248). Through social capital, Bourdieu argued, actors have more direct access to economic resources that benefit them than other people; can increase their cultural capital through contact with experts or individuals of refinement; or affiliate themselves with institutions that confer valued credentials (Portes 2000). These elements that a wealthy individual can muster created a power gap between wealthy taxpayers and tax officials who were relatively young and inexperienced.

One respondent reflected upon his feelings when dealing with an HWI by saying that ‘there is a psychological barrier when dealing with taxpayers ... a sense of inferiority’ (RI020, tax official). This situation is understandable as the vast majority of HWI taxpayers in Indonesia have strong connections with high-level officials in other institutions (either civil or military) or political parties, people who would protect their interests or help them when they were dealing with government agencies (RI015, RI023, tax advisers; RI002, RI020, RI021, tax officials). HWIs’ relationships with someone with more authority (e.g. government ministers) than the HWI unit officials put staff in an ‘inferior’ position.

#### *Dealing with other sections of the DGT*

Similar problems occurred when the unit was dealing with other parts of the DGT. In the first few months of the HWI unit’s operation, following the Director General’s verbal instruction, the unit attempted to develop a taxpayers’ database. In doing so they

asked for information from other TSOs that administered information about HWIs' related entities.<sup>68</sup> As 'there is no difference' in terms of authority between the HWI unit and other TSOs, such dealings were difficult. The unit did not have sufficient authority to force other TSOs to comply with its requests, nor to extract information from other units in the DGT at higher levels (e.g., regional offices or directorates at headquarters) (RI024, tax official).

This impediment was multiplied by the fact that the considerable dispersion of the DGT's operational offices (TSOs) has made administrative coordination and cooperation between the HWI unit (located in Jakarta) and other TSOs around Indonesia very challenging.

#### *Dealing with other institutions*

The other impediment that the HWI unit in Indonesia had to experience was in dealing with other institutions either within the MoF (e.g., other directorate generals) or other ministries. Developing an HWI taxpayer database meant the unit had to gather information from various institutions. The principles regulating 'who can contact whom' in Indonesian bureaucratic culture mean that when two different institutions, even if they are under the same umbrella (e.g., one ministry), communicate with each other they must be represented at the same level of organisation. Thus, it is regarded as unacceptable conduct for an echelon III unit (e.g., in the DGT) to send a letter to an

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<sup>68</sup> In Indonesia taxpayers are administered in a particular TSO based on their residence or any specific criterion such as business categories (especially for corporations). All taxpayers' information is centralised in the headquarters. Each TSO is granted access only to information related to taxpayers registered in its office. The alternative way to get information in relation to taxpayers registered in other TSOs is by requesting needed information from relevant TSOs or asking headquarters. The later alternative is the last resort because of the bureaucratic procedures that must be followed.



echelon II unit, even in the same ministry portfolio (e.g., Directorate General of Customs), let alone in a different ministry (e.g., Ministry of Industry and Trade). This organisational bottleneck hindered the work of the HWI unit in constructing a more comprehensive HWI database through collecting data from other institutions and developing an integrated approach that links all entities related to a particular HWI.

#### *Summary of Indonesia's tax system*

Indonesia's tax administration has been facing pressures from two different directions. As the institution which is the primary revenue generator for the state's budget, DGT has been under pressure to maintain revenue targets through a top-down approach. On the other hand, the tax system still has fundamental problems of low tax compliance, as reflected in three widely used indicators: a low number of registered individual taxpayers compared with estimated potential registrations; a low proportion of registered taxpayers filing tax returns; and a small amount of tax actually collected compared with the tax potentially collectable (a wide tax gap).

With respect to the cultural background that greeted the introduction of an HWI unit in Indonesia, three observations are particularly important. First, the main focus of any efforts made by the DGT to improve revenue collection was pursuit of revenue targets determined through a 'top-down' decree rather than a 'bottom-up' process. The reason was because revenue targets were (and are) politically sensitive, not only for lower-level tax officials (chiefs of regional offices or tax service offices) but for top-level officials (i.e., the Director General). Revenue achievement dominates principles of purpose for tax policy in the Indonesia context. This is not to say, however, that other principles are ignored completely. Service provision, efficiency, and good governance are part of

Indonesia's tax policy principles, but revenue has been the dominant narrative in its policy deliberations and priorities.

Second, the strong demand to achieve tax revenues led to tension about what should be happening on the ground. Some tax officials clearly believed that attention needed to be given to building better relationships with taxpayers. Others were drawn to the older methods of coercion and used whatever methods they perceived were needed to meet the revenue target assigned to them. This suggested there may be principles in conflict, at least at some levels of the DGT. A related issue that emerged from my analysis was the geographically dispersed nature of the many offices of the DGT in Indonesia. The challenge of coordination for the DGT with respect to the introduction of new policy cannot be underestimated.

Third, the organisational structure of the DGT proved to be an impediment to the implementation of the HWI initiative; it was not flexible enough to tolerate the structural changes required for implementing the policy. Placed in the lowest-level in DGT's organisational structure, the HWI unit faced challenges when dealing with wealthy taxpayers, with other units within the DGT, and with other institutions.

## **5.2 Policy transfer of the HWI initiative in Indonesia**

This section describes various sources of influence that led to the decision to transfer HWI policy to Indonesia, actors' awareness of the existence of the same policy elsewhere, and identification of actors involved in the policy transfer process.

### **5.2.1 Global influence and local pressure: rationales for transfer**

Three sources of influence led the Indonesian government to adopt an HWI policy. The first was a study commissioned by the OECD's Forum on Tax Administration (FTA) on tax compliance issues of HWIs worldwide. The idea for the study was raised in the FTA's fourth meeting in Cape Town, South Africa in January 2008 (OECD 2009a). In March 2008 the OECD set up a 'focus group' consisting of tax officials from 14 countries (Australia, Canada, Ireland, Italy, France, Germany, Japan, Mexico, the Netherlands, New Zealand, Norway, South Africa, the UK and the USA) to carry out the study (OECD 2009a).

The study produced recommendations for best practices for dealing with HWIs.

The experience of countries that have already implemented some or all of those best practices suggests that firm action when combined with good compliance activity and good service can significantly improve compliance by HNWIs [high net-worth individuals]. (OECD 2009, p. 3)

One of the recommendations was for tax authorities to establish special units within their structures, but the OECD had no power to mandate this. The role of international tax forums, such as the OECD's FTA or SGATAR for Asia and the Pacific region, is more 'to promote dialogue between tax administrations and to identify good (or best practices) tax administration practices' (Pinto & Sawyer 2011, p. 27) rather than to impose practices on its members or other countries. Actors in the Indonesian tax administration acknowledged inspiration from the work of the FTA in the establishment

of the HWI unit in DGT.<sup>69</sup> This appeared in a document produced by DGT and was confirmed in a respondent's response to my question:

Special treatment for high wealth individual Taxpayers [sic] has been studied by various international forums such as the OECD...and SGATAR.... (HWI TSO 2010a, p. 10)

In terms of policy we learnt from other countries ... we also read the OECD document. (RI020, tax official)

The second influence from the global sphere came from a so-called 'invisible force' (Rose 2002, p. 9) pushing policy-makers to pay attention to what their counterparts in other countries were doing. Indonesia wanted to be part of the world society (Meyer et al. 1997) of modern tax administration. As discussed in Chapter 1, a desire to conform to a world-wide model of good government has contributed to the convergence of institutional structures globally. The Indonesian tax administration was an example of this. The DGT's former vision statement revealed the organisation's desire to become a modern institution: 'Be a model of a government institution that implements a world-class taxation management system' (Purnomo 2004, p. 219).<sup>70</sup>

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<sup>69</sup> Although the report was published in 2009, in October 2008 FTA published a discussion paper which described the project and invited public comments. FTA also sent questionnaires to tax authorities that had already implemented HWI initiatives. There was international awareness and dialogue around the project before the final report was published.

<sup>70</sup> The vision was then revised to: 'To be the best tax administration in South-east Asia' (Directorate General of Taxation n.d.)

High-level officials in the Indonesia MoF (RI018) and DGT (RI030) whom I interviewed noted that ‘modern’ was a key word that distinguished tax administration reform in 2002 from the previous reforms (1980s and 1990s).<sup>71</sup>

The 2002 tax reform was substantially very different from the previous reforms. What was that substantial difference? Previously [reforms] did not clearly mention: ‘modernisation’. ‘Modern’ in what sense? That is, by adopting universal principles of ‘good governance’ that have been widely adopted by other countries. (RI018, former tax official)

If we looked at the HWI program, we could not see it as a stand-alone policy. It is part of a process ... a process to be a modern tax administration. (RI030, former tax official)

The third source of influence for establishing an HWI unit came from the GFC that occurred in the last quarter of 2008. In the previous section of this chapter I demonstrated that revenue from taxes has been the mainstay of the Indonesian State budget. However, the GFC affected Indonesia’s economy in different ways (Djaja 2009), including the revenue side of the country’s budget. According to Djaja (2009, pp. 2–5), some sectors that contributed the most to the Indonesian economy such as plantations, mining (including oil and gas), the manufacturing industry and to some degree the trade sector were vulnerable to external shocks when demands from the international market eased as the global turmoil worsened in 2008. Consequently, income that Indonesian corporations (or corporations that reside in Indonesia) made from their businesses declined. As business income declined due to global economic conditions, government anticipated a decline in tax revenue from corporations (corporate income taxes), the mainstay of tax revenue. The MoF and DGT tried to find a

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<sup>71</sup> Tax administration reform in 2002 was a stepping stone for DGT reform, including the establishment of LTOs, restructuring of TSOs, and ultimately the establishment of HWI tax service offices.

way to reduce high dependence on the corporate sector for tax revenue through changing course to address the individual taxpayer sector seriously for the first time. The change of direction was welcomed by tax officials, who reported that the individual taxpayer sector had ‘been abandoned for many years in the Indonesia tax system’ (RI027, tax official) and recognised that ‘Indonesian income tax law gives more attention to corporations than to individual taxpayers’ (RI009, tax official), as also appeared in a DGT document:

The establishment of the HWI Tax Service Office is an integral part of the modernisation of tax administration that has been undertaken by the DGT since 2002. At the start of the modernisation process, DGT only focused on corporate taxpayers. Since 2009 ... DGT broadened its focus to include individual taxpayers. This practice has been adopted in other countries, which were mostly generating revenues from individual taxpayers. (HWI TSO 2010b, p. 7).

In contrast to income tax revenue from corporations, which was volatile in response to global economic crises, personal income taxes were relatively stable, at least in the short term. A senior official told the story of the initial idea behind the HWI initiative.

According to my knowledge, this HWI unit was formed to reverse the distribution of tax revenue that had been dominated by corporate income tax. The Minister [of Finance] wanted personal income tax to contribute more to the tax revenue. This idea came from the high proportion of personal income tax revenue in other countries, especially developed countries. It was the initial idea. Of course there were other reasons behind it. (RI009, tax official)

... the structure of our tax revenue is highly skewed to CIT, unlike developed countries that we went to [when we made study visits], where the role of personal income tax was dominant. (RI020, tax official)

Domestically, pressure that led to the decision to adopt an HWI policy came from the Indonesian President, Susilo Bambang Yudhoyono. In July 2009, Indonesia was scheduled to hold its second direct presidential election, after the New Order era. SBY was running for his second and final term as President.<sup>72</sup>

As mentioned in earlier chapters, in preparation for the election and the last year of his presidential term, SBY introduced a series of quick-win initiatives. Framed by the bigger theme of bureaucratic reform, the quick-win program resulted in a range of flagship programs from different government agencies. These program allowed ‘the benefit...[to] be felt immediately by the stakeholders’ and the general public, and were chosen ‘to provide a positive image for the implementation of bureaucracy reform’ (Indonesia Ministry of Administrative and Bureaucracy Reform 2011, p. 3). A document revealed instructions to government agencies to ‘set “quick-wins” [programs] that are expected to increase credibility, reputation and trust in your [government agency] in the eyes of the stakeholders [public]’ (UPRBN Technical Team – Ministry of Administrative and Bureaucracy Reform 2012, p. 18). The initiatives could be in different forms, depending on the core business of the institutions. For example, the Indonesian National Police proposed, among other things, a quick-win program by which procedures for someone to get a driving license would be more transparent (State Minister for the Empowerment of State Apparatus 2009).

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<sup>72</sup> The result was that SBY returned to the office with a landslide election; won by gaining almost 60.80 per cent of votes.

My research revealed that the DGT was given opportunity to nominate a program that would support the President's agenda. In a DGT leadership meeting in late April 2008, the idea of establishing an HWI unit was raised:

The idea to establish a program for managing high wealth individual taxpayers first appeared in the Board of Directors meeting in the DGT to implement the quick-wins program. (DGT 2011, p. 1)

Events presented above are consistent with the literature that suggests that a fiscal crisis (e.g., Berry & Berry 1992; Sharman 2010), global networks (e.g., Cao 2010; Gilardi & Wasserfallen 2009), and the political imperative to 'do something' (Sharman 2010) are factors contributing to the introduction of new tax policy.

In the Indonesian context, the fiscal crisis came in the form of anticipated declining tax revenue due to global financial turmoil. Global networks took the form of the epistemic community of tax experts housed in the FTA and the dialogue that took place around the HWI compliance project. The political imperative to 'do something' took the form of nominating flagship programs for the presidential election in 2009. These events, however, by themselves do not prove that the HWI unit in Indonesia is a case of policy transfer in Dolowitz and Marsh's terms.

Dolowitz (1997) argued that demonstrating actors' awareness of and interest in the policy and institutions of other systems is important to prove the occurrence of transfer: 'Without proving that actors were aware of other models and interested in them, even if policies look alike[,] it is not possible to prove this was the result of transfer' (p. 24). While the OECD provided a forum for widespread discussion, the evidence is not yet



present to show that those who decided to pursue the HWI initiative in Indonesia were also the people familiar with the development abroad.

### **5.2.2 Indonesian actors' awareness of and interest in HWI initiatives elsewhere**

Indonesian policy-makers' level of awareness of HWI operations elsewhere is indicated in the following quote from DGT reports:

In some countries (such as Australia, Canada and France), individual taxpayers who fall into the high wealth category are specifically administered by tax authorities through the establishment of a taskforce [special unit]. (Indonesia HWI Unit 2010, sec. Executive Summary)

My interviews with high ranking officials similarly revealed actors' awareness of the HWI initiatives operating elsewhere, with particular reference to the ATO's HWI Taskforce and the OECD report in which the operations of such initiatives in other countries were discussed.

When we came up with the idea to establish an HWI unit, we looked to Australia. We understood that they already had a model. A model used for managing tax compliance of HWI taxpayers. (RI030, former tax official)

Well ... I already knew, which was actually somewhat influential to us in terms of our high-wealth individuals initiative ... for administering personal income tax of the very wealthy, [is] Australia's model, I knew [about the HWI dedicated unit] from there [Australia]. (RI037, former tax official)

Both the respondents quoted above held strategic positions in DGT at the time of the establishment of the HWI unit. Their statements, therefore, represented actors' awareness of the existence of the model elsewhere. Another senior official commented:

‘As far as I know ... what people mostly referred to [with this initiative] is Australia’ (RI009, tax official).

Interest in the Australian program was manifested by the DGT sending a delegation consisting of three senior officials (echelon III level) to the ATO in December 2008. The delegation spent five days (from 8 to 12 December 2008) in the ATO’s HWI Taskforce southern region office in Box Hill (Melbourne) to learn about Australia’s HWI Taskforce.<sup>73</sup> One of the delegation members revealed:

Yes ... we knew that Australia had a model for their HWIs. That’s why we were sent there to learn about the model. We had a presentation about their HWI taskforce: its structure, its functions, how it worked, its results, etc. Our main task was writing a report from that visit and presenting it to the Committee.<sup>74</sup> (RI041, tax official)

On this evidence, policy transfer is an appropriate model to use for the establishment of Indonesia’s HWI unit. At the same time, forces of globalisation were at work in a broader sense in Indonesia that affected its tax administration. The path had been laid for establishing a HWI unit within DGT in 2002 by establishing two LTOs dedicated to big corporate taxpayers (RI030, tax official). A senior tax official told this story in the interview with Schalkwyk of Princeton University’s Oral History Program (Schalkwyk 2009, pp. 1& 5):

In my experience, I think actually before the Ministry of Finance started its reform, DG Tax has [sic] started earlier, around 2002, our own reform which we call [sic] it Tax Administration Modernization. So that was the first time we established a new [tax

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<sup>73</sup> One other delegation member had left the DGT and lived abroad, and the other was unable to participate in the interview.

<sup>74</sup> The Committee was called the Committee for the Preparation of the Establishment of a High Wealth Individuals Tax Service Office.

service] office, large tax-payer office [LTO], which is like a starting of a pilot project of an ideal office for the future. So we started in 2002 and then step-by-step, one by one, we add more and more offices to be modernized. (p. 1)

When we modernized [these] two offices [LTOs], the modernization of the offices was the beginning of everything. (p. 5)

As already noted, Indonesia's tax administration system wanted to be seen as a modern tax administration by implementing certain measures that reflected state-of-the-art administrative arrangements: '... lean organisational structure, information technology that facilitates better service and monitoring, and professional human resources with a strict code of conduct...' (Purnomo 2004, p. 219).

### **5.2.3 Identified agents of transfer**

Richard Common (2001, p. 30) has argued that in the case of policy transfer it may be difficult to identify with any precision where policy-makers acquired ideas, policies and lessons, or even which actors were involved in policy transfer. In the context of the HWI initiative in Indonesia, there is evidence of three actors playing an important role: the DGT, the IMF as an adviser, and the ATO as an adviser.

Domestically, bureaucrats/civil servants and tax officials can be identified as agents of transfer. They set the policy agenda in that DGT chose the policy that they took to the MoF to get approval. DGT then implemented the HWI policy.

Once DGT had chosen the HWI unit as its quick-wins program, it realised it needed assistance from parties in the international community who had access to experience and knowledge. The second actor identified as playing a role in transferring the HWI program in Indonesia was the IMF (through its representative in Indonesia).

The IMF played the role of facilitator in relation to the HWI unit. It had operated as an initiator when Indonesia reformed its tax administration after the Asian economic crisis in 1997. The IMF initiated the restructuring of tax offices; the Fund's loan was conditional on such reform (Brondolo et al. 2008; Rizal 2011). A senior official revealed the background of the 2002 tax administration reform (Schalkwyk 2009, p. 1).

It was part of a Letter of Intent with the IMF (International Monetary Fund). We had a crisis here in 1998, and we had difficulty – I mean the government of Indonesia had some difficulty with our economy. There is an agreement; I think we borrowed some money ... the IMF was kind of overseeing our reform. If I may say, the trigger is basically by the Letter of Intent or commitment with the IMF program. The IMF kind of proposed making this new office [LTOs], because they are very concerned regarding our capability to generate revenue. I mean, at that time, the government of Indonesia has to be able to generate its own domestic revenue.

The official from the DGT saw the contribution from the IMF quite differently in relation to the HWI unit:

The idea was coming from us (RI020).

We utilise [them]... [We told them,] 'We want to establish an HWI unit'. [Respondent asked me] Do you know...what advantages do the IMF, World Bank and other International agencies have? They have good networks. So when we asked [about] the HWI initiative, they immediately contacted their networks [to know about] where the HWI programs exist; what their success stories were; what did not work and so on. Well ... those became inputs for us. (RI030, former tax official)

The IMF provided assistance through its country advisor who was posted at the DGT.

IMF provided advisors to aid in formation and development of the dedicated office and to review progress and make recommendations. A number of dedicated visits were made by IMF officials from May 2009 to February 2011.<sup>75</sup> (RI040, international organisation)

The Fund's adviser also accompanied the DGT delegation to Melbourne to learn about the program (DGT 2011). The role of the IMF continued even after the HWI unit had been established by providing technical assistance, reviewing progress of the program (IMF 2009) and also providing recommendations when in 2011 the DGT planned to expand the initiative to other regions outside Jakarta (IMF 2011c). This plan, however, was cancelled for 'political reasons' (RI041, tax official).

The third actor playing a critical role in the transfer process was the ATO. In his 2010 Annual Report, the ATO Commissioner reported on the Office's role in assisting the establishment of the HWI office in Indonesia (ATO 2010, p. 123):

Our work with Indonesia assisted their successful establishment of the Indonesian Directorate General of Taxation's High Wealth Individual Office....

Australia had a close relationship with Indonesia in terms of economic cooperation, manifested in the establishment of AIPEG. AIPEG was aimed at assisting the Indonesian government in achieving its economic goals by strengthening the government's capability for policy formulation, coordination and implementation in areas affecting the national budget and macroeconomic performance (AIPEG 2010a). Australia provided assistance to Indonesia in its tax reforms.

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<sup>75</sup> A DGT document revealed that dedicated visits to Indonesia by IMF officials started in January 2009 (Large Taxpayer Regional Office 2010, p. 38) after the idea to establish an HWI unit was raised in DGT's board of directors meeting in April 2008.

Many donors have assisted DGT in its [sic] reforms. However, AusAID holds the unique position of being the only international donor that has provided continuous support to DGT's transformation efforts. The current support vehicle is AIPEG which is assisting DGT to improve its tax administration and management capacity and to implement new initiatives. This continuous support ... has led to the development of very strong relationship between DGT and AIPEG advisers, with AusAID now being regarded as the most consistent supporter of the DGT modernization program. (AIPEG 2010b, n.p.)

Under this partnership framework, senior ATO officials were deployed at the DGT. Their role was to provide technical advice in areas such as transfer pricing, tax auditing, and risk assessment. A seconded official from the ATO also acted as a liaison officer between the ATO and the DGT when the DGT decided to learn about Australia's HWI taskforce.

We promote good governance in tax administration globally. We facilitate international secondments and arrange for our technical speakers to address overseas training programs. We also participate in the Australian Government's capacity-building programs in countries such as Indonesia ... working closely with AusAID and the Department of Foreign Affairs and Trade. (ATO 2010, p. 123)

Senior HWI Taskforce staff made a series of visits<sup>76</sup> to the DGT to share their knowledge about the HWI program, particularly in terms of its operation at the very early stage: client identification, risk assessment method, information technology used, staffing, and information security. A respondent from ATO's HWI Taskforce recalled his trip to Indonesia to share his knowledge about forming an HWI unit.

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<sup>76</sup> The first visit was conducted from 14 to 19 June 2009 when two senior HWI Taskforce officials visited DGT's HWI tax service office to give presentations about the HWI Taskforce. The second visit was on 24 June 2009 when another two senior ATO officials accompanied by the IMF Resident Advisor visited DGT's HWI unit.

I think when [RA005] and I went over ... that was just after or just before DGT really sort of started doing this ... put in place this unit. (RA004, tax official)

I was in the high wealth individual taskforce for fifteen years and I built up a lot of expertise ... and that might be one reason why [RA004] and I went to Indonesia because we have that experience. (RA005, tax official)

A high-level official serving in the DGT at the time acknowledged Australia's role:

We wanted to find a way for making [wealthy] individual taxpayers pay their fair share of taxes, we did benchmarking [of the policy] and we saw the model of the high wealth individual initiative [in Australia]. They [wealthy taxpayers] are monitored by a special unit.... (RI037, former tax official)

In summary, the above discussion shows that three levels of influence operated in the policy transfer of the HWI initiative into the Indonesian tax administration: international, national (domestic), and organisational. Table 5.5 summarises the rationales for why Indonesian actors engaged in the policy transfer of the HWI initiative, the actors involved in the process, and the primary source of learning about the policy.

**Table 5.5 Policy Transfer of the HWI Initiative in Indonesia**

Why engage in transfer?	Who was involved in the transfer?	What was transferred?	Prime source of learning
<p>International factors:</p> <ul style="list-style-type: none"> <li>• Recommendation of ‘best practice’ in managing tax compliance of HWIs appears in FTA study report (voluntary)</li> <li>• Desire to conform to ‘modern society’ (voluntary)</li> </ul>	<p>International actors:</p> <ul style="list-style-type: none"> <li>• IMF as advisor</li> <li>• ATO as advisor</li> </ul>	<ul style="list-style-type: none"> <li>• Regulatory arrangement for managing tax compliance of the very wealthy taxpayers (HWI unit)</li> </ul>	<ul style="list-style-type: none"> <li>• Australia’s HWI Taskforce</li> </ul>
<p>Domestic factors:</p> <ul style="list-style-type: none"> <li>• Political imperative to ‘do something’ (coercive)</li> <li>• Fiscal crisis (coercive)</li> </ul>	<p>Domestic actors:</p> <ul style="list-style-type: none"> <li>• Politician (Indonesian president)</li> <li>• Bureaucrats (Ministry of finance and DGT senior staff)</li> </ul>		
<p>Organisational factors:</p> <ul style="list-style-type: none"> <li>• Organisational mission for collecting tax revenue</li> </ul>	<p>Organisational actors:</p> <ul style="list-style-type: none"> <li>• Senior officials sent to Australia</li> <li>• Official at DGT headquarters</li> </ul>		

### 5.3 Indonesia’s HWI initiative: example of an unsuccessful transfer?

As discussed in Chapter 2, for assessing policy, Bovens et al. (2001) distinguished between its programmatic and political dimensions. Since this research focused on the implementation stage of a transferred policy, the argument for the success or otherwise of the HWI policy was made on programmatic grounds rather than the political grounds.

I claim that the HWI unit was programmatically unsuccessful.



In assessing policy from a programmatic perspective, the focus is on policy effectiveness, efficiency and resilience. In this research, a programmatic perspective on policy assessment included three aspects: outcome, resources, and operation (Marsh & McConnell 2010), with key questions asked about each aspect as follows.

- Outcome: Did the policy achieve the intended outcomes?
- Resources: Was the policy an efficient use of resources?
- Operational: Was the policy made operational in a way that was consistent with achieving its objectives?

### **5.3.1 Outcomes: Did the HWI unit achieve expected outcomes?**

The HWI unit's performance with respect to program achievement was disappointing. The HWI unit was located within the Large Taxpayers Regional Office (LTRO) portfolio. The LTRO contributed 37 per cent (247.55 trillion Rupiah) of the total tax revenue of 669.54 trillion Rupiah collected by the DGT in 2011<sup>77</sup> (Directorate of Potential, Compliance and Revenue 2012, n.p.). The HWI unit, however, contributed only 625.12 billion Rupiah (0.25 per cent of LTRO revenue). This insignificant amount of revenue compared to other LTOs (and even certain STOs<sup>78</sup>) had become a source of criticism in every national coordinating meeting (*rakornas*) and a source of pressures for HWI unit staff. Figure 5.6 illustrates revenue contributed by the HWI unit compared to other LTOs in 2011.

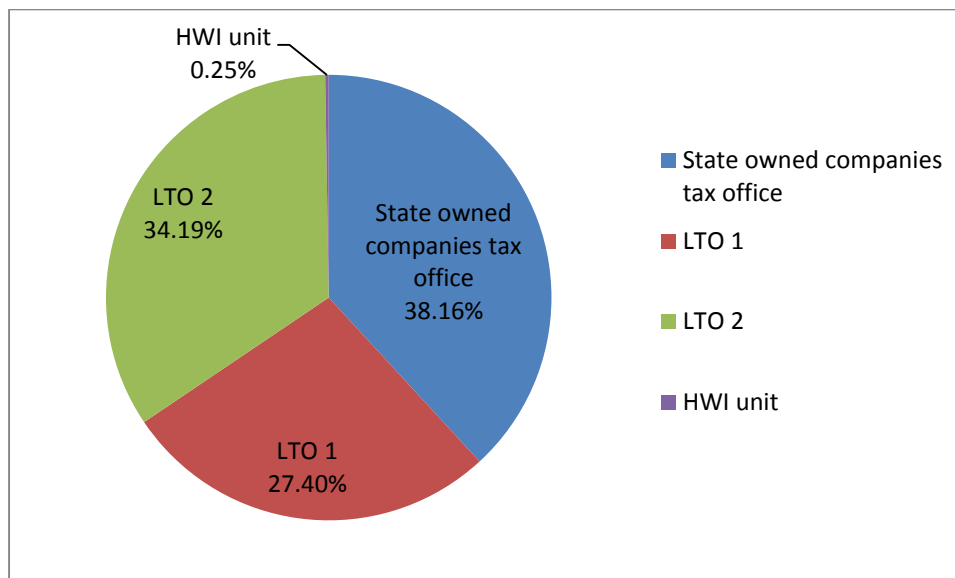
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<sup>77</sup> This was the last fiscal year of the HWI unit operating as a dedicated unit solely for administering HWI taxpayers. In 2012, the HWI unit's name and function were changed (see Chapter 8, section 8.4) because it began administering tax for enterprises as well as HWIs.

<sup>78</sup> *KPP Pratama Banda Aceh*, an STO in Nanggroe Aceh Darussalam province, for instance, collected 966.05 billion Rupiah in 2011 (Directorate of Potential, Compliance and Revenue 2012, n.p.).

A report from the MoF office described pressures received by the HWI unit staff (General Secretary of Ministry of Finance 2010, p. 20).

The relatively small tax revenue the unit generated compared to other units under the Large Taxpayer Regional Office [portfolio] has put staff [at the HWI unit] under considerable psychological pressure; the contribution was only 0.23 per cent [in 2010] of the total tax revenue of Large Taxpayer Regional Office ... Staff in the HWI unit experienced pressures such as the threat of redeployment [to rural areas] if the unit did not meet targets and internal pressure from the DGT headquarters to continuously increase tax revenue. These pressures worsened the working climate for officials serving in the unit.



**Figure 5.6 Revenue contribution of the HWI unit compared to other LTOs within LTRO portfolio (2011)**

Source: DGT (2012), author's calculation.

### 5.3.2 Resources: Was the HWI unit an efficient use of resources?

The IMF advised on the formation of Indonesia's HWI unit; in its report, it suggested that the HWI regulatory model that had been established in the Jakarta area had potential to be expanded to other regional offices across Indonesia (IMF 2011c, pt. III). The initial HWI unit only had jurisdiction for Jakarta; therefore, HWIs residing outside

Jakarta were untouched by this initiative. If this idea was realised each regional office would have one unit dedicated to administering HWIs in its region. This idea, however, was not followed up. An internal DGT document revealed the following reasons for not following up this recommendation (Directorate General of Taxation n.d., p. 6):

As the result of our cost-benefit analysis suggested ... establishing a new unit specifically intended for administering HWI taxpayers is not the right option ... From the collection cost efficiency ratio (CCER) point of view, administering HWI taxpayers by establishing dedicated units [such as the one in Jakarta] in other regions ... is inefficient.

The same opinion was expressed by a prominent Indonesian tax consultant (RI003), who was concerned that the investment required to establish regional HWI units would be greater than the tax the unit could collect.

### **5.3.3 Operations: Was the HWI unit made operational in a way that was consistent with achieving its objectives?**

When Australia introduced an HWI initiative in its administration, subsequently acknowledged by the OECD as an effective measure for improving tax compliance of HWIs, the objective was not merely generating revenue from this segment. The Australian HWI initiative's primary goals were to gain a better understanding of HWIs and their related entities and act accordingly. The follow-up actions from that understanding could be compliance activities (e.g., auditing or prosecution) or administrative and legislative proposals to address tax minimisation practices undertaken by HWIs or their entities (The Auditor General 2000, p. 10 ).

Indonesia's HWI unit did not operate to the standard of its Australian counterpart. The following quotes are views from different actors about the operation of the Indonesian HWI unit.

It's like a toothless tiger. (RI001, tax consultant)

This unit cannot stand alone, right? It must be supported by other elements that must be created, so that the unit can be successful. If there are no such elements, as it is now, it's useless. (RI008, tax consultant)

Why do you think the HWI unit is considered unsuccessful? The HWI unit cannot function optimally, because it cannot see taxpayers and their business activities as a whole [holistically]. Because it could be that all their lifestyles are financed by the company, all their investments are made on behalf of the company and the unit has no access on it. (RI029, former tax official)

One high-level official commented that Indonesia's HWI unit did not meet expectation in relation to achieving its higher-order objective: enhancing the confidence of the Indonesian taxpaying community that the DGT's compliance activities were directed at the wealthy as well as ordinary taxpayers (RI033, tax official). The unit was merely intended to generate revenue, which, as shown above, was not achieved either.

#### **5.4 Discussion and analysis: the design of the transfer of HWI policy**

*Hypothesis 1(a): Policy transfer of the HWI initiative in Indonesia occurred due to a political imperative to “do something” to satisfy powerful actors who used the policy to advance their political agenda of being recognised as having a modern bureaucracy.*

*Hypothesis 1(b): Policy transfer of the HWI initiative in Indonesia had elements of coercion and voluntariness. Coercion was strongest at the levels of the national government and the administering organisation, the DGT. Voluntariness was accompanied by active enlisting of advice at the international level from the epistemic community of tax experts. This mix of pressure had implications for how much learning as opposed to emulation could take place.*

The evidence presented above suggests that various influences led the Indonesian tax authority to adopt an HWI policy in 2009.

#### **5.4.1 Domestic pressures and influence**

The introduction of the HWI initiative in Indonesia was one of many quick solutions proposed in response to a command to reform the national bureaucracy. The 2009 presidential election was a major factor in the establishment of the HWI policy in Indonesia (as it had been in Australia – see Chapter 4). In Indonesia, the HWI unit was launched a few months before the presidential election in 2009. The introduction of the HWI initiative before an election could be seen as an effort by the incumbent government to attract public support based on the government doing something with regards to wealthy people who, in the general public's perception, were not paying their fair share of taxes. This position was taken by the Australian government when introducing its own HWI policy (Chapter 4).

Pressure to be seen to be doing something in the run-up to an election, with limited time available to implement the policy, made the transfer of the HWI policy in the Indonesian tax administration more a process of policy emulation than policy learning. This is not to say, however, that this was an either-or situation. Indeed, part of the DGT tried hard to learn about the policy and to understand how the policy could be implemented in the Indonesian context. Having DGT officials travel to Australia to learn about HWI policy was part of that learning process. But limited time available to implement the policy and demands for rapid results made success almost impossible to achieve.

Unlike policy learning, where the objective consequences of a policy are well considered (i.e., whether the policy has been successful elsewhere, and if so, how could it be just as successful in a new context), emulation actors do not pay much attention to a policy's objective consequences. What matters in policy emulation is the symbolic and socially constructed characteristics of policies (Maggetti & Gilardi 2014). Simmons, Dobbin and Garrett (2006, p. 801) argued that countries emulate the behavior of their self-identified peers, even when they often cannot ascertain that doing so will in fact fit their own context.

As the anticipated tax revenue from corporate taxpayers declined in 2008, the State budget suffered. This was the other domestic factor that shaped DGT policy and became a source of influence for transferring the HWI policy. However, the short-sighted orientation of Indonesia's tax system towards achieving annual revenue targets meant that the HWI policy was also oriented to short-term goals. This meant that DGT missed an opportunity to use the HWI initiative to improve the taxpaying culture of individual Indonesians, in particular very wealthy ones, and to promote a system with which taxpayers would cooperate.

#### **5.4.2 International influence**

Internationally, influence came in the form of policy documentation that opened Indonesian policy-makers' eyes to the phenomenon of the fast-growing population of the very wealthy and the risks they posed to the integrity of the tax system.

Indeed, the epistemic community of tax experts played an important role through introducing higher-order principles of modern tax administration: good governance, efficiency, accountability, and transparency (OECD 2001b). But the way in which the

epistemic community spread the idea was far from coercive in the HWI policy: The focus was on deliberation and sharing of knowledge and experience from those countries with an HWI unit to those countries without such a unit. This is consistent with the OECD's main functions, which are oriented more towards encouraging countries to share their experiences, develop best practices and set international standards (Owens 2005, p. 1) than to impose certain practices or regulations on countries (in contrast to bodies like the IMF, which, for instance, imposed bankruptcy law in Indonesia as part of loan conditionality in 1998 (Steele 1999)). Eccleston (2006, p.9) noted that although the OECD avoids an advocacy role, its role in disseminating specific policy agendas, including taxation policy, has been pivotal. In relation to tax administration issues, the policy agenda was disseminated by OECD's FTA.

The FTA was created as a forum for dialogue through which tax administrations could 'identify, discuss and influence relevant global trends and develop new ideas to enhance tax administration around the world' (OECD n.d.). In promoting best practices of tax administration, the FTA works in 'a collaborative fashion and engages in exploratory dialogue' with involved actors (Pinto & Sawyer 2011, p. 27). To ensure that the results of its work are available to as many tax administrations as possible, the FTA publishes the results of key studies in the form of reports and information or guidance notes in the tax administration guidance series (OECD n.d.). Voluntary compliance with international best practices of tax administration, rather than coercion, is the norm in this epistemic community.

The other reason, in the tax policy arena, why voluntariness is so prevalent is because '[t]here is no "anchor" as far as domestic tax institutions are concerned' (Radaelli 2000, p. 35). Although Radaelli discussed this issue in a broader context of tax coordination

among members of the EU in areas of direct tax policy, similar conditions apply in tax administration. The OECD has recognised that the way in which a regulatory model such as an HWI unit is practised might differ from one country to another depending on their circumstances (OECD 2008, p. 4), including a country's tax laws, organisational structure of tax administration and availability of resources.

All of these pressures and influences resulted in high expectations of the DGT in general and the HWI unit in particular. This expectation, without any accompanying deep consideration of the resources needed to achieve it, invited disappointment. This is because as tax administrators, actors involved in the transfer process gave more attention on technical aspects of the policy. They were not used to looking at a problem from a bigger perspective such as policy consultants or policy 'think tanks' might (Stone 1996). DGT initiated and implemented transference of the HWI policy to the Indonesian tax administration in a very short time span. The broader taxpaying context and how the HWI unit might contribute in this context were overlooked.

#### **5.4.3 Structural flexibility to accommodate new policy**

*Hypothesis 2: Transferring a complex policy such as HWI unit requires flexibility in organisational structure that is able to tolerate structural changes to accommodate mechanisms required to achieve policy outcomes.*

In the discussion that follows, I conclude that these two hypotheses are broadly supported. The discussion about DGT organisational structure in section 5.1.4 showed that this factor contributed to the failure of implementing the HWI policy due to its rigidity to adopt change. In order to provide the HWI unit with more authoritative



power, for instance, the unit should have been placed in a higher position than a TSO. This seemingly simple matter had major consequences in the Indonesian context, seriously hindering the work of the HWI unit.

When a policy developed in a more mature democracy (Australia) is transferred to a relatively immature one (Indonesia), it can be hindered more by institutional constraints than other factors (e.g., personnel or skills): ‘... socio-political and bureaucratic obstacles in each country impede or block the implementation of good practices’ (the World Bank cited in Rose 2005, p.1). By analysing HWI program implementation in the Indonesian tax administration, I content that the institutional structure that hosted the program was not flexible enough to accommodate changes that are required to implement new practices. As the result, the HWI program in Indonesia did not develop as it was promoted by the epistemic community.

Implementation of the HWI program required an organisational structure with more authoritative power than was given due to the challenges posed by HWI taxpayers. The ATO gave an example by granting its HWI Taskforce a coordinating role among other business lines. This privilege, however, was not enjoyed by Indonesia’s HWI unit. Rigidity of organisation in Indonesian ministries in general and the DGT in particular, reflected in the complex process needed to place the program in a higher level of organisational structure (see section 5.1.4), resulted in consequences that policy-makers had not foreseen: challenges in dealing with taxpayers, with other units within the DGT, and with other institutions.

Failure to anticipate the challenges that arose from organisational structural factors, to some extent, was caused by the failure to recognise ‘the cause-and-effect links’ (Rose

2005, p. 73) between policy elements, for instance, between the level of organisation and authoritative power in the eyes of other units within DGT, taxpayers, tax advisers, and other government institutions. Moreover, as Rose suggested, a cause-and-effect model of a policy facilitates policy-makers in the adopting country to consider what would happen if the policy under consideration were introduced in a new setting. Although actors recognised that organisational structure was one of the factors that might impede the success of the implementation of the HWI program in Indonesia, the hierarchical and bureaucratic nature of Indonesian tax administration meant the lessons learnt during the visit to Australia could not be implemented: ‘People learn but organizations decide’ (Rose 2005, p. 94).

## **Conclusion**

This chapter documents the adoption of the HWI initiative by the Indonesian tax administration. Included in my review are forces that influenced the decision to adopt the HWI initiative in Indonesia, a description of Indonesia’s taxpaying culture and inherent problems experienced by the Indonesian tax system, and a depiction of the Indonesian tax administration at the time the policy was introduced.

Adoption of the HWI policy in Indonesia was influenced by international, domestic and organisational factors. The epistemic community of tax administration experts in the OECD advocated the idea that countries should dedicate resources to monitoring the tax compliance of HWIs as well as providing services. The Indonesian tax authority embraced this idea: It needed to improve its reputation, craved positive recognition as a modern tax administration, and expected to collect more revenue. The policy, however, did not meet its potential when it was implemented in Indonesia. The policy failed in

terms of achieving expected outcomes, its efficiency in using available resources and implementing mechanisms consistent with achieving its objectives.

Inherent problems experienced within the Indonesian tax system include low tax burdens and high non-compliance, tax officials being motivated by revenue targets and not interested in individual taxpayers, a taxpaying culture dominated by disengagement with the tax system, and a hierarchical organisation of tax administration with highly centralised power and extreme geographical dispersion of offices. Understanding these elements when a developing country attempts to transfer a policy from a developed country is crucial. No policy works the same way in different contexts. The Indonesian tax context differs markedly from that of Australia, from which the HWI policy was largely adopted. The context, therefore, affects how the HWI policy is operationalised.

Given that context matters in adopting a policy from other jurisdictions, it is vital to examine more closely the organisational and legislative structures and procedures in which the HWI unit was embedded. Actors involved in policy transfer, especially those from the adopting country, need to critically analyse how the policy under consideration might operate in their own context when they understand that there is a great structural gap between the transferring and adopting country, such as that between Australia and Indonesia.

The structural factor that hindered the implementation of Indonesia's HWI unit most significantly was the organisational level of the unit, which was substantially different from that of international best practice. In a country such as Indonesia, where the culture of 'large power distance' exists, in which 'hierarchy in organizations reflects the existential inequality between higher-ups and lower-downs' (Hofstede 1997, p. 37),

structure matters. The DGT placed the HWI initiative in an organisational position where the structural level of the unit and its authoritative power was too low.

This seemingly simple feature of organisational structure reflects a crucial aspect of transferring policy from a different setting: flexibility to adopt structural changes. Inflexibility of organisational structure to accommodate the HWI unit in a level that gave sufficient authoritative power hindered the unit when dealing with taxpayers, other parts of the DGT, and other institutions.

Implementing a transferred policy, however, is not only about organisational structure. Understanding the principles underlying the policy is important as well. In the following chapter I discuss how influential actors interpreted policy ideas based on their understanding. Influential actors set objectives that they prioritised above others. Such actors exerted their influence to ensure that the HWI unit implemented mechanisms that furthered these objectives.

# Chapter 6

## Policy Slippage in Transfer of Principles and Mechanisms

*The establishment of this tax service office [HWI] is a manifestation of Government's appreciation of the wealthy taxpayers who have or should have made a significant contribution to state revenues...*

(Directorate General of Taxation 2009)

### **Introduction**

This chapter describes the implementation of the HWI unit in Indonesia. I introduced the concepts of principles, mechanisms and actors in the research model outlined in Chapter 2. Influential actors use available mechanisms to enact principles and achieve objectives; the overall purpose is to regulate and coordinate activities to achieve certain ends, while simultaneously preventing dissent and the pursuit of alternative pathways by competing interests. In this chapter I describe the way in which elite actors in the DGT exerted their influence to ensure that the HWI unit was implemented in a way that suited their objectives.

This chapter consists of three parts. The first part opens with a discussion of the early period of the HWI unit's processes before DGT leadership changed (I called it 'the first period' of the implementation of HWI unit). During this period, the top leadership understood that the HWI unit was a 'long-term policy' (RI038, former tax official) oriented to building a better relationship with taxpayers and eliciting greater compliance. Its policy goals could only be achieved through long-term investment in relationship building, and its success or failure could not be measured merely by revenue target achievement in the short term.

Then follows a discussion of the period when the leadership changed (the second period). The succeeding Director General interpreted the HWI policy differently, probably due to his background in tax enforcement. During this period, internal tensions rose. The HWI unit was seen merely as a revenue generator; consequently all its mechanisms were directed toward this goal. New practices introduced under the first regime were abolished. Different implementation priorities were set by influential actors who understood the policy differently.

The second section of this chapter compares two mechanisms used in the HWI unit operation under both Director Generals: the taxpayer's data management system and staff retention practices. The former mechanism was essential for managing the tax compliance of HWIs. Effective compliance management required the tax authority to gather information on individuals and on entities related to them. This could only be achieved by changing the old practices of treating each taxpayer's return (personal or corporation) as a separate case. This innovative approach was introduced by the ATO's HWI Taskforce as part of their strategy to obtain a holistic picture of an HWI's tax

compliance. The holistic understanding of the tax compliance of HWIs and their entities could only be obtained through developing a more integrated system.

The second mechanism of interest discussed in this chapter defined the operations of the HWI unit under the second regime and was related to how staff were managed in order to change the direction of the HWI unit. Understanding HWI's tax compliance required tax officials to learn about the tax and business affairs of HWIs and their related entities and to master more complex and sophisticated laws and regulations to deal with non-compliance. This knowledge and expertise could only be obtained through long-term deployment of staff in the HWI area.

The last section of the chapter contains an overall discussion and analysis of the findings. It describes my use of the evidence presented in the earlier sections to test two hypotheses: learning about implementation of the HWI policy requires understanding of the principles underlying the policy, and an understanding of the principles underlying the HWI policy is essential for choosing an appropriate mechanism for implementing the policy.

## **6.1 Different understandings of the principles underlying the HWI policy**

The following sections present evidence on how influential actors gave different meaning and priority to the HWI policy in Indonesia. The two periods of leadership in the short life of the HWI unit reflected these differences. In the first period, the HWI policy was interpreted as a means for developing relationships with taxpayers and restoring trust in the DGT, in the second period the policy was interpreted as a means for generating revenue – a long-held overarching principle of the DGT.

### **6.1.1 The HWI initiative as a ‘relationship improvement’ program: first period of the HWI unit’s operation**

The HWI program was introduced in readiness for a presidential election campaign which was keen to boast of accomplishment in bureaucratic reform. The stated purpose of the quick-win program was ‘to provide a positive image for the implementation of bureaucracy reform’ (Indonesia Ministry of Administrative and Bureaucracy Reform 2011, p. 3). The initiative was one of many ‘low hanging fruit’ – easily-achieved actions with benefits that the public could feel in less than one year (UPRBN Technical Team—Ministry of Administrative and Bureaucracy Reform 2012).

The DGT suggested to Government that the HWI unit be as part of the quick-win program for two reasons. First, DGT aimed to improve its image with the taxpaying community through focusing on the top-end segment and improving the services provided to this sector (RI030, tax official). As HWIs were (and are) economically as well as politically powerful, DGT believed that its image with the general public would improve if they could impress wealthier taxpayers with the service they were offering. By proposing this program, DGT saw itself making a positive contribution to the President’s efforts to position himself for a second term in office.<sup>79</sup>

The second and less overt purpose for proposing an HWI unit was anticipation of declining tax revenue from the corporate sector due to the GFC that occurred in September 2008, and interest in increasing tax collection from individuals as opposed to

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<sup>79</sup> It could be interpreted as the tax authorities being partisan in favour of one politician against others. With a presidential system of government in Indonesia, any government institution—including DGT as part of Ministry of Finance portfolio—serves at the pleasure of the president.



corporations. Informed by the OECD report about the fast-growing population of HWIs globally and the tax revenue they might contribute if their tax compliance was managed properly, DGT used the HWI policy as a measure to ‘kill two birds with one stone’. On the one hand it was intended to satisfy political imperatives to provide a quick-win program through service improvement, and on the other hand it was aimed at generating revenue from HWI taxpayers as a stepping stone to ‘turn the revenue proportion to become PIT [personal income tax] dominant’ (RI020, tax official).

The initial purpose of the formation [of the HWI unit] was to turn our tax revenue proportion from being dominated by CIT [corporate income tax] into PIT. If our policy focus was revenue, then we gave more attention on corporate taxpayers, because in the short-term it could generate revenue easier. But, if we wanted to increase revenue from individuals a lot of things could be done, and it is a long-term [process]. (RI022, tax official)

Although the objective of revenue-raising existed from the beginning, DGT chose not to disclose it to the public. Information in the public sphere proclaimed that this initiative was dedicated to providing a better service to HWI taxpayers.

Formally ... what we disclosed to the public was that this unit was established to provide [HWI] taxpayers with better services. In fact, at the same time we wanted to closely monitor them. (RI013, tax official)

In addition, an IMF report noted that:

The stated goals of the HWI program are to educate high wealth taxpayers, provide service and enhance the voluntary compliance of these taxpayers. Originally, the DGT decided to focus on taxpayer service and outreach and to postpone audits for the first year of operations. (IMF 2011, p. 14)

In March 2009, the Indonesian President launched the HWI unit in a festive ceremony (see Figure 6.1) – as was also the case in the launching of such programs in other agencies by other high-ranking government officials. Indonesian newspapers reported the event with an emphasis on ‘service’. As depicted in one national newspaper: ‘The President ... officially commenced on Wednesday the operation of the nation’s first tax service office designed to serve the country’s billionaires’ (Adamrah & Suharmoko 2009). A statement DGT press release following the launching ceremony described the DGT position in relation to HWI taxpayers as follows:

The establishment of this [HWI] Tax Service Office is a manifestation of Government’s appreciation of the wealthy taxpayers who have or should have made a significant contribution to the State revenues and is also intended to ensure that wealthy taxpayers get better service in fulfilling their tax rights and obligations as well as in obtaining information in relation to tax laws in a more complete and timely manner. (Directorate General of Taxation 2009)



**Figure 6.1 The Indonesian Minister of Finance, the Governor of Jakarta, the President of Indonesia and the Director General of Taxation signing off on the formation of the HWI unit, March 2009**

Source: *Presiden Republik Indonesia* (2009)

*Leadership within DGT on relationship improvement*

At the launch of the HWI unit, the Director General of the DGT stated (in front of HWI unit officials who has been selected through a rigorous process<sup>80</sup>) that the focus in the early stages was to be on maintaining good relationships with taxpayers and their advisers in order to win back trust from the taxpaying community. At the same time, the unit was asked to develop a good understanding of HWIs' business and tax arrangements through developing a taxpayers' database. In fact, the unit was not given revenue targets for its first year of operation. The following quote is from a mid-level

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<sup>80</sup> The selection process was so rigorous that staff being interviewed felt so proud of being part of the first generation of the HWI unit (RI027, tax official).

official at the HWI unit who claimed to clearly recall the wording of the Director General's speech.

...the Director General said, 'You are not burdened by revenue targets. Because your job is to improve their [HWI taxpayers'] compliance ... to change [their behaviour] from not compliant into more compliant. What will we do? By providing better service, reminding them [with regard to their tax obligations] and so forth. There will be breakthroughs such that, at the end, taxpayers will feel that we have started to become friends'. (RI024, tax official)

Mr Nasution, the Director General at the time of the HWI unit's inception was not a career official, and was in fact the first from outside the DGT. He was appointed in 2006 by the Minister of Finance, Sri Mulyani Indrawati.<sup>81</sup> The appointment of Mr Nasution was understood as the Minister's effort to gain public confidence in the DGT, widely regarded as one of the most corrupt institutions in Indonesia at that time (World Bank 2003, p. 4).

It was understood publicly, therefore, that the HWI unit's purpose was to improve service to HWIs rather than to undertake compliance activities toward them. The public would be sceptical if the DGT publicly announced that it was going to increase the compliance of HWIs due to DGT's long-known corrupt practices.

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<sup>81</sup> Finance Minister Sri Mulyani Indrawati was well-known a reformer in the MoF in general and the DGT in particular. She was also acknowledged for building a reputation for integrity and was credited with reducing corruption and increasing efficiency in the MoF during her leadership (Devlin & Schalkwyk, 2009). In the middle of her tenure she resigned from the position to become one of the three Managing Directors of the World Bank Group (Mealey & Hanlon 2010). There were widespread speculations that her resignation was due to political pressure (Allard 2010; Siahaan et al. 2010; Suharmoko 2010), especially from a powerful tycoon who was also a chairman of the biggest political party in Indonesia (Gelling 2010; Witular & Hapsari 2010). Her resignation occurred soon after she won support for establishing the HWI tax office within the DGT.

Well, you know why [we have difficulties to urge people to comply]? Because we do not start with building trust, [rather] we started by saying, ‘You have to pay taxes rightfully’. [Then the public would respond], ‘You should do the right thing, first’. (RI037, former tax official)

It's unpopular [policy]. Our first strategy was ... what we said [to the public] ... what we highlighted was ‘service’, [by saying] that everything will be made easier for them. But we know what’s behind the screen, we have a strategy of monitoring as well, but we wrapped it with the word of ‘service’. (RI030, former tax official)

Actors at the operational level in the HWI unit understood that in its first few years, they were expected to achieve the following: restore this taxpayer group’s trust in the DGT; develop good relationships through a more personal approach to taxpayers and their advisers; develop a database through a profiling program which included data from third parties; and understand taxpayers’ business arrangements by identifying all entities under their control (RI024, tax official).

This strategy (i.e., focus on service and outreach programs) was developed because DGT’s leaders believed that ‘taxpayers would be more compliant in the long run if they fully understood their responsibilities and were given a chance to comply voluntarily’ (IMF 2011, p. 14).

External stakeholders viewed this strategy as a reward that HWI taxpayers deserved to receive; as compensation for the tax they have paid and acknowledging their economic status and political power (RI011, other organisation; RI016, other organisation). One respondent argued that it was acceptable to treat taxpayers differently based on their socio-economic status: ‘It is understandable if they [HWIs] are treated differently from general taxpayers ... because they are richer and politically stronger’ (RI016, other

organisation). The meaning was more of offering politeness than of surrendering power and becoming captured by more powerful forces outside DGT.

*Passive resistance at the top*

While the focus on service and outreach programs was supported by the majority of staff at the operational level and stakeholders outside the DGT, passive resistance was observed among actors at higher levels in the DGT headquarters. However, because disagreement with one's superiors is unacceptable in the Indonesian bureaucratic culture (Labolo 2013, p. 165), this disagreement was not articulated openly, rather it was manifested in passive resistance (RI010, former tax official).

A former high-level official openly disclosed his disagreement with the idea of using service as a strategy when dealing with HWIs as follows.

Taxpayers are never expecting service from us. That is not what they expected. Do not ever think that by providing a better service they will be more compliant. That is not true. (RI029, former tax official)

The DGT publicly articulated strategy of promoting service provision to HWI taxpayers as the HWI unit's primary purpose was contrary to what was done in Australia when the ATO introduced its HWI policy in 1996. On many occasions, the Australian government and the ATO publicly reinforced the idea that the HWI initiative was a program 'to improve the compliance of high wealth individuals with our [Australian] income tax laws' (Costello 1996, p. 7) and 'to improve ... understanding of these individuals and their groups, identify their tax planning techniques ... contribute to tax reform and build community confidence in the tax system' (ATO 2008, p. 7). Service was one of the elements of concern to the ATO in dealing with taxpayers; providing

service to taxpayers was a commitment contained in the *Taxpayer Charter* and was embedded in the compliance model. However, when the HWI program was established and was introduced to the public in general, and HWIs and their advisers in particular, it was not ‘service’ that emerged as the prime purpose of the program.

Indonesia’s strategy for the HWI unit in its first stage was criticised by a respondent from an international organisation as having ‘started from the wrong premise in relation to this group of taxpayers’ (RA014, international organisation). What the respondent meant was that by choosing a strategy focused on service provision, the Indonesian tax authority presumed that taxpayers in this group were already in a state of willingness to consistently comply with all their tax obligations, or in other words, were displaying the posture of ‘commitment’ to the tax system (V. Braithwaite 2003b) (see Chapter 4 about motivational postures in the ATO’s pyramidal compliance model).

The Director General understood that the policy strategy he chose with regard to HWIs might be criticised, but believed it ‘was the best of a bad set of choices’ (RI0037, former tax official) in a situation where ‘people have little faith in state institutions’ (World Bank 2003, p. 4) such as the tax authority. His plan was that in the first few years of the HWI unit’s operation compliance activities should be deferred to give time to develop public confidence in the DGT, build relationships with HWIs and advisers and gain knowledge in relation to the HWIs’ business and tax affairs. This strategy seemed to be favoured by staff at the operational level, as they knew how negative

relationships with taxpayers had been in the past and how taxpayers' data was still 'messy' (RI024, tax official)<sup>82</sup>.

Our task, in my opinion, was working out how to change the bad perceptions that already existed in the minds of the public regarding tax officials and the DGT as an institution. (RI022, tax official)

Even after two years of the HWI unit's operation, taxpayers' physical data [e.g., tax returns, audit reports, assessment letters, etc.] had not been collected from other TSOs. (RI024, tax official)

The Director General's interpretation of the HWI policy as 'relationship improvement first, and revenue collection later' was implemented on the ground by DGT's most highly skilled and carefully selected staff. As one staff member (RI027, tax official) observed, they were proud to be part of this new unit designed to improve Indonesia's tax system. They undertook activities to build relationships with taxpayers and their advisers (e.g., by visiting taxpayers and introducing staff designated as a taxpayer's contact person) and worked at understanding a taxpayers' profiles through taxpayer database development (e.g., by compiling data from internal or external sources in a program developed by HWI unit's staff). They did not do any compliance activities such as auditing.

*What have we learnt?*

Comparing what had been done by the Indonesian tax authority with what happened in Australia reveals two contrasts in how the two countries introduced their HWI

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<sup>82</sup> Before taxpayers were administered by the HWI unit, they had been administered in other TSOs around the Jakarta region. Taxpayers' physical data (e.g., master file, tax returns, assessment letters, audit reports, etc.) were scattered across those TSOs and should have been collected in the HWI unit. This process proved less easy than imagined.



initiatives. The Australian government and the ATO deliberately raised the issue about the need for closer scrutiny of taxpaying performance of the rich and their related entities – issues that easily gained public and political support thanks to the context in which the HWI initiative was introduced (as described in Chapter 4). In other words, the Australian government and the ATO were ready to use their authoritative power to tackle tax minimisation practices employed by small portions of society that could undermine the overall integrity of the tax system.

In contrast to the Australian approach, in Indonesia the tax authority chose to take a more subtle, arguably subservient, position to the taxpayers who would be the target of this new initiative. The Indonesian government and DGT did not send a signal to the general public that closer scrutiny of HWIs and their entities would be applied through this new initiative; they did not present taxpaying as a public duty, as was done in Australia. Instead of advocating for the general public and the collection of taxes from the very wealthy to support the country, with the promise of service provision the Indonesian tax authority actually took the side of wealthy taxpayers. Nevertheless, despite this apparent failure of imagination, the reasoning on Indonesia's part may have been sound. HWIs and their advisers were virtually the sole contributors to individual tax in Indonesia. Unlike in Australia, there was not a large population of middle and lower income-earning taxpayers (Yuwono 2009) who might resent the wealthy shirking their responsibilities. Under such circumstances, the Indonesian Government and the DGT may have had concerns about push-back from the HWI sector.

In implementing a policy transferred from another place, context matters. Although the strategy chosen by the DGT was criticised because it 'started from the wrong premise' about HWI taxpayers, it is of relevance that almost all respondents at the operational

level (in the HWI unit) agreed with the strategy to improve relationships with HWI taxpayers as the priority for the first years of operation, before conducting compliance activities in the following years. In the Indonesian context, where the public had little trust in government agencies in general and the tax authority in particular (World Bank 2003), rebuilding relationships with taxpayers who were disappointed with the conduct of tax officials in the past was a defensible policy strategy. Moreover, staff in the HWI unit knew that in order to prosecute compliance activities competently they needed to be ready with a strong database, because they would be dealing with sophisticated tax planning arrangements protected and defended by the ‘smartest and brightest tax advisers’ (RI014, academic).

### **6.1.2 HWI initiative as revenue generator: second stage of the HWI unit operation**

The first period of HWI implementation and the philosophy behind it, however, did not endure after the DGT leadership changed. As documented in an IMF report: ‘With the change in the Director General ... the focus [of the HWI unit] changed quickly to enforcement and audits’ (IMF 2011, p. 14).

The new Director General was a DGT career official and had long experience in compliance. He was known as a ‘hard official’ (RI024, tax official) in the enforcement area. One respondent described how the new Director General was really concerned with revenue targets<sup>83</sup>:

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<sup>83</sup> After the first year, the HWI unit was given a revenue target of 563 billion Rupiah.

That [‘service’] period<sup>84</sup> only lasted a few months. After the new Director General came into office it was a totally 180-degree turn. It was changed completely. Where initially we had never thought of revenue, suddenly he came here and said: ‘Why are your revenue targets only five hundred billion Rupiahs? It is as small as [the revenue targets of] a TSO in Atambua ... or do you want me to move all of you there!’<sup>85</sup> (RI024, tax official)

Another respondent had similar views.

But it was not even a year [of the HWI unit’s operation], then the Director General was replaced. The new Director General ... you know ... His direction was not clear enough. We were always demanded to do compliance activities. We ... people on the ground ... got confused. How could we do compliance activities if the data we had were not strong enough? (RI002, tax official)

This respondent continued to say that since the new Director General took charge every effort the unit made was directed toward achieving revenue targets through compliance activities. For instance, they set aside their work on revamping the database and collecting data from third parties in order to develop a better understanding of taxpayers’ business structures. Information was still being gathered from other parties, but the orientation was merely intended to generate revenue either from counselling or auditing.<sup>86</sup> As discussed in Chapter 5, achieving revenue targets at the end of the financial year is used as a performance indicator against which the TSO chief is

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<sup>84</sup> That is, a period in which staff members were required to develop relationships with taxpayers and their advisers and to develop a taxpayers’ database.

<sup>85</sup> Atambua is a small city in East Nusa Tenggara province near the Timor-Leste border. It is a common belief within the Indonesian bureaucracy that being moved to a small rural and city, especially one outside Java, is ‘punishment’.

<sup>86</sup> Counselling refers to a practice used by DGT to clarify any discrepancy found in the tax return using external data. In this process, it is possible that the taxpayer would agree with the DGT’s findings and pay the additional tax owed, or defend his position by providing an explanation and evidence with regard to the discrepancy. With the latter condition, DGT can accept the taxpayer’s explanation and close the case, or refuse the taxpayer’s explanation and ask the taxpayer to pay the tax owed. If taxpayers refuse to pay the tax owed in this counselling stage, then this process can be escalated into auditing or investigation depending on whether or not there is an element of criminal offence in the case.

evaluated. Achieving revenue targets could mean promotion or at least deployment to a more strategic position.<sup>87</sup> Failing to achieve them, on the other hand, is likely to lead to demotion.

An official at the HWI unit related that he was always embarrassed when he represented his unit in regional and national meetings, at which every unit's profiles (i.e., revenue targets and achievement) were presented. Since the HWI unit was under the LTRO portfolio, its targets and achieved revenue could be compared with other LTOs. According to this informant, in this context the HWI unit's contribution looked like 'an ant among elephants' and became 'the object of ridicule' (RI009, tax official) (see Chapter 5, section 5.3.2 for the revenue contributed by the HWI unit and other LTOs).

With a background mostly in the compliance area, the new Director General interpreted the HWI policy differently to his predecessor. The HWI unit was requested to perform compliance activities. It was seen as a means to achieving revenue targets. The unit no longer had special status. It was on a par with other TSOs and was expected to perform accordingly.

Substantial change in policy direction at the top, without involving actors who had been implementing the HWI policy on the ground, made staff feel like they were 'walking against the wind' (RI009, tax auditor). They felt the HWI policy and unit lacked direction. This change in interpretation of the policy, according to some respondents, was due to the absence of any written policy strategy for the HWI unit. There was no

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<sup>87</sup> Moving to headquarters, for instance, although still in the same level/echelon, is an example of a more strategic position and is regarded as promotion. In contrast, moving to a TSO in an 'unfavourable' place (e.g., a rural area) is regarded as demotion although the level/echelon is unchanged.

basis on which the innovative thinking behind the HWI unit could be raised within the DGT and discussed openly in terms of its successes and failures. No opportunity existed for learning from experience. In the minds of some respondents, influential actors were setting policy direction based on their interests. As one mid-level official revealed:

In my opinion, the blueprint should have been made when this unit was first established; to set the direction for this unit for the next five or ten years ... whoever the DGT's Director General is, that blueprint would be applied. In fact [the blueprint of the HWI policy] did not exist. (RI002, tax official)

This perspective also appeared in the IMF report:

[T]here is still no written and approved comprehensive broad-based strategy document necessary to provide direction to the various Directorate stakeholders [in relation to the HWI policy]. (IMF 2011, p. 14)

In short, the two leadership periods during the early years of the HWI unit's operation involved significantly different approaches. The same policy was understood and implemented differently according to the leaders' interpretation of the principles underpinning the operation of the unit. The principles that influential actors favoured, apparently based on their personal preferences rather than on written documentation, steered the direction of coordinated action on the ground. In the first period, a philosophy of 'relationship improvement now, enforcement later' gave meaning and purpose to the work of operational staff within the HWI unit. The philosophy of reaching the revenue target which defined the second period was consistent with the traditional philosophy and ways of working within the DGT, but left the HWI unit staff feeling dismissed and humiliated, without an agenda that they saw as meaningful and productive.

## **6.2 Different mechanisms used by different actors**

As the policy principles of the HWI program were interpreted differently by different actors in the two leadership periods described above, the mechanisms employed to achieve policy objectives changed. When the HWI initiative was understood as a long-term policy, staff acted with the intention of restoring relationships with taxpayers who had been disappointed with the DGT as an institution and in the often unreasonable conduct of its officials.

When the HWI unit's mission was redirected toward achieving revenue targets, traditional mechanisms with which the public were familiar began to resurface, with new legitimacy conferred from above. These mechanisms were attached to the long-held tradition of coercion in DGT and the long-held norm that revenue target achievement was the paramount goal of the tax system. How revenue was collected and at what cost to taxpayer morale was irrelevant. In the second period of the HWI unit's operation, this old mechanism became entrenched and there was no room to try new practices.

In this section I compare the primary mechanisms used in the two periods of leadership to embed a philosophy into the operations of the HWI unit. The first period was one of modernisation and development with the intention of changing how the DGT engaged with taxpayers. The second period was one of relapse, reinstating past practices and bringing a halt to any new way of thinking about how the DGT should function. The mechanisms were not directed only at the HWI unit staff; they were designed to unsettle DGT operations across the board and herald a new way of operating and engaging with

the public. These mechanisms are the development of the taxpayer's database period and the practice of staff rotation.

### **6.2.1 Developing a taxpayer database: the innovative and traditional approaches**

As noted above, the HWI unit began its existence under direction to improve relationships, and learn more about the operation of HWIs. This learning was to be captured through a taxpayers' database. Staff could use this database to track the affairs of HWIs, gathering a body of data over time that would reveal their tax obligations as well as the tax they paid. This mechanism is important when dealing with HWIs due to the complexity of their affairs, as an informant from an international organisation who assisted DGT asserted.

HWIs commonly employ tax avoidance strategies that use complex business transactions involving multiple related businesses. Often, HWI enterprises include large numbers of individual businesses that file tax returns in different offices. In its current process, the DGT conducts risk assessments and audits on individual entities, not on the enterprise as a whole. Also, the DGT divides its audit program into separate offices (i.e., STOs, MTOs and LTOs). High-risk transactions that cross functional lines can be easily overlooked. (RI040, international organisation)

Furthermore, this respondent criticised DGT's information technology, stating that it was unable to capture a holistic picture of HWIs' tax affairs.

Adding to the problem is ... the inability of the administration to even identify and document the often large number of businesses controlled by the HWI. The information technology systems are more geared toward the processing of tax returns rather than the use of the information system to aid in identifying these relationships. Since the major compliance risk lies with the business enterprise in its entirety, risk analysis and audit need to be conducted holistically rather than separately.

The database, therefore, was a core mechanism for realising the objective of the HWI unit to ensure that HWIs paid their taxes correctly in the longer term. Staff argued that the database needed to integrate data on the tax affairs of wealthy individuals and their related entities: the idea was accepted by headquarters. Through being able to access taxpayer's personal tax data as well as tax-relevant data from related entities, the HWI unit staff improved their knowledge of how HWIs used tax planning techniques to minimise their tax obligations.

Technically, this process of bringing together personal and entity data violated the DGT's general rule of data access. The general policy was that each TSO (including the HWI unit) had access only to data of taxpayers administered in the office; special requests had to be made for information about particular entities administered in other TSOs, either directly to the relevant TSOs or to headquarters. The transfer of files from one part of DGT to another was made more difficult by the fact that files were often paper files.

In short, the information technology and regulatory infrastructure with regard to data sharing between the HWI unit and other parts within the DGT, and between the DGT and other institutions was not sufficiently supportive of the needs of the HWI unit when it was established. Consequently, staff working at the unit needed to find ways that facilitated the gathering of relevant information from a variety of sources. These sources included other government institutions such as national land titles offices, the Indonesian Financial Transaction Reports and Analysis Centre, government vehicle registry offices, non-government institutions such as the Indonesian Stock Exchange, and the property sales database maintained prominent property agents and developers.



Instituting the mechanism of amalgamating data about taxpaying individuals and their entities from a variety of sources, setting up a database within the DGT so that individuals could be tracked over time, and observing tax planning arrangements was a logical challenge for the DGT. Nevertheless, its value was not doubted in the first period of the HWI unit operation. This holistic approach for monitoring tax compliance of HWIs and their related entities had proven effective in improving compliance of this taxpayer segment in Australia (Braithwaite & Braithwaite 2001; Hong & Braithwaite 2011). This mechanism was understood to require a long-term investment in collecting data and training staff to use these data. Results of higher tax collection from HWIs would not be obtained immediately. Although the data presented above show that the HWI unit had free rein to develop its database in the first period of its operations, it is of note that no formal evidence exists that headquarters approved the practice. Most importantly, no Director General's decree explicitly sanctioned this practice to ensure its continuation.

When the new Director General came to office in July 2009, the process of developing and using such an integrated database was stopped. The reasoning was twofold. First, the HWI unit was expected to revert to the old practice of requesting taxpayers' data that was administered in other TSOs. This process, although possible, was not simple or efficient due to the long-held bureaucratic mentality of staff in other parts of DGT. Moreover, activities such as data integration of HWIs and their related entities were time and resource intensive, and did not produce tangible short-term benefits in terms of tax collected. These activities therefore were less valued than compliance activities such as counselling or auditing. For these reasons, the resources of the HWI unit were

directed toward activities designed to produce short-term results (i.e., revenue generation).

Second, rules governing the functioning of the bureaucracy were used to restrict access to taxpayer and entity data across DGT and within the HWI unit in particular. The information-sharing culture between units in DGT was set back through the use of a conservative interpretation of Article 34 Paragraph 1 of Law Number 6 of 1986, which regulates how tax officials provide information with regard to taxpayers.<sup>88</sup> As one official put it:

As you know ... we are only an echelon III unit [the level of most other TSOs] ... when we ask for information with respect to related entities of a particular HWI from other tax service offices ... we're trying desperately but for little result. In fact we have been told that they [other TSOs] are bound by Article 34. Can you believe it? It's funny, isn't it?  
(RI018, tax official)

This situation has made staff in the unit feel 'demotivated' (RI025, tax official). This respondent went on to describe the situation he and his colleagues faced as 'living in the clouds'. This referred to their knowledge of the existence of large amounts of information that could be used in developing understanding of tax compliance of the HWIs and their entities, but which they could not obtain or use. One respondent in the LTRO, which supervised the HWI unit, agreed with this opinion by saying that 'they [people in the HWI unit] are hungry for information [in relation to taxpayers], but they have not received adequate support to obtain the needed information' (RI021, tax official).

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<sup>88</sup> Article 34 paragraph 1 stipulates that 'Any official shall be prohibited to provide an unauthorised party with any information he/she knows or is informed about as a tax official by a taxpayer in the course of his /her duties'.

The mechanism of information sharing and the integration of data on HWIs and their entities was an essential part of the operations of the HWI unit when DGT leaders were pursuing the principle of relationship improvement and improved understanding of HWI activities. In the second period of the HWI unit's operation, a change of leadership in DGT brought about a resurgence of the target revenue principle for the HWI unit (along with other units). Sanctioned mechanisms also changed accordingly. The new Director General favoured the old practice of sharing information only when special requests were made, and the practice appears to have been given lower priority than each unit achieving its revenue targets. Influential actors represented contesting visions for the future of the HWI unit and supported a different mechanism of HWI unit operation. These different mechanisms profoundly influenced the HWI unit's procedures, and in the second period the long-term effectiveness of the HWI unit was seriously undermined.

### **6.2.2 Staff rotation as an organisational imperative**

Although not explicitly disclosed, it was understood that actors in strategic positions recognised the importance of staff retention for the building of an effective HWI unit. This could be inferred from the statement that 'staff at the HWI unit will serve longer in the unit [compared to time served in other units]' (RI038, former tax official), because they needed more time to develop their knowledge in a new field and had more experience than necessary for effective management of HWI compliance.

Staff retention is a feature that makes the HWI regulatory initiative quite different from tax authorities' other initiatives to promote tax compliance. The reason that commonly emerged to justify this pattern was that gathering, analysing and understanding information with respect to wealthy taxpayers and their related entities is a task different

from administering ‘ordinary’ taxpayers or publicly owned companies (OECD 2009a). The tax affairs of salary and wages-earning taxpayers are simpler than those of HWIs. Moreover, the publicly available information on wealthy people is limited, and privately owned companies related to HWIs are not subject to disclosure requirements as is the case with public companies. Consequently it requires more effort to gather information with regard to HWIs and their related entities. Even after the information is accumulated, understanding the information and linking it to produce a complete picture of an HWI’s webs of business arrangements is complex, as is the next step of assessing any risks that this arrangement poses to tax revenue. Such work demands more time for tax officials to comprehend the issues, as this respondent from an international organisation suggested:

...you need more information to understand how these taxpayers derive their income and conduct their affairs ... So that’s part of the learning. All of these are learning experiences that evolves over time ... I guess the point I am making in relation to high net-worth individuals is the fact that it involves a long-term process. (RA014, international organisation)

Moreover, greater expertise is required to do the job well. Tax officials in the HWI area are required to grasp very complex business and tax laws and regulations so that they are able to correctly apply laws and regulations in particular situations. A respondent from the ATO’s HWI Taskforce, who was advising Indonesia’s HWI unit, noted that it was not easy to deal with the complexities of the HWIs and their entities.

Yes, it’s not easy for a couple of reasons. The first reason is the law to which they tend to operate ... is very complex ... very complex to understand. And the other issue is that they tend to have very sophisticated lawyers. So it is not just income tax law that you have to concern with, it’s also administrative law. Not all of us are lawyers. (RA003, tax official)

As HWI taxpayers typically employ very well-paid and high-quality advisers to carry out their business and tax affairs, it follows that the tax officials who deal with HWI taxpayers must be of similar quality if they are to succeed (RA004, tax official). Having technical capabilities equivalent to these advisers gives the HWI unit staff the authority needed to address HWI taxpayers and their advisers. This view was consistent with that of respondents from international organisations who had experience with Indonesia's HWI program. The following respondent used the term 'expertise gap' to depict what he saw as the significant difference in the expertise of Indonesia's HWI unit officials and HWIs' advisers:

... the biggest challenge [for Indonesia] in administering HWI taxpayers is the *expertise gap* between the tax administration staff and that of the HWI taxpayer's financial and tax advisers. Further complicating this in the DGT is the *rotation policy*. Most enforcement and service employees are rotated to other positions within two years. Financial and tax advisors of the taxpayer normally have many years' experience coupled with their intimate on-going relationship with the taxpayer and their businesses. In developed countries, a large percentage of HWI administration employees spend a majority of their career in that dedicated unit acquiring both a knowledge of the taxpayer as well as expertise in dealing with wealthy individuals and interrelated businesses. (RI040, international organisation, emphasis added)

An ability to identify tax risks in complex structures and arrangements, to build relationships with HWIs and their advisers, and to respond to queries from wealthy individuals in a clear, timely and consistent manner is crucial for staff in the HWI unit (Ernst & Young 2010, p. 29). This expertise can only be obtained through serving a reasonable amount of time in the HWI unit, as this respondent from the ATO who has been in the Taskforce since its inception commented as follows:

When you set up [a HWI unit] you need to retain staff for a lengthy period of time because it takes a long time to build the capability of someone to look after a group of three hundred entities ... I think someone once placed the figure on that at about six years to build the capability ... If you keep shifting people around, that capability will never be built ... there's a lot ... you have to learn [in relation to] private groups. Private groups are very different from the public groups, where there's a lot of openness and transparency and a lot of public reporting. (RA004, tax official)

In the initial stage obviously capability of staff is a major challenge. Because you know, we work with very complex laws, and structures, and groups. And knowing the commercial aspect of how a business is run – it is obviously important for officers to understand that. (RA010, tax official)

Such capability, according to a senior HWI Taskforce official in Australia, who was involved in providing assistance to DGT, comprises 'hard skills' and 'soft skills'. The hard skills include the ability of staff 'to go out, get information, talk to the taxpayers and their advisers, and make sure they get facts and evidence', whereas the soft skills include background knowledge and astuteness in following the legal and technical aspects of very complex transactions and their relation with the tax laws (RA005, tax official).

Retaining staff for a longer period of time in the HWI unit develops their understanding of taxpayers in terms of their business and tax affairs, and builds expertise where specialised staff are needed. It also offers institutional benefits through strengthening recommendations for the development of administrative and legislative proposals to address aggressive tax planning techniques practised by HWI taxpayers. Treating staff in the HWI unit like all other staff in the DGT in terms of their placement duration, a 'business as usual' mechanism of staff deployment, risked limiting knowledge accumulation and meant that expertise in the HWI unit was never built properly

(RA004, tax official). Moreover, tax minimisation techniques develop rapidly, so tax officials must follow the field closely. This issue was raised by another respondent from an international organisation who supervised the DGT in developing its HWI unit.

[DGT] must first recognise the problems caused by this [expertise] gap and move swiftly to hire competent employees and continually train them. Risks posed by HWIs and tax avoidance techniques change swiftly. (RI040, international organisation)

Under the new DGT leadership in the second period of the HWI unit's operation (July 2009 to January 2011), staff rotation applied without exception. The general pattern was that staff at a certain level (generally echelon IV and above) were rotated to a different office every two or three years. This policy is based on an anti-corruption principle. If staff are moved after a short period time, they are less likely to be corrupted and collude with the taxpayers they administer. This principle, which has merit in its own right, clashed with the principle of improving relationships with taxpayers and advisers and learning more about their business, which demanded that staff serve more time in the HWI area.

One middle-level official in the HWI unit reflected his experience when he and other section heads were rotated to other offices even more quickly than was the norm in DGT:

We were planning to serve there [in the HWI unit] for at least two years, until the unit was mature enough. But in fact, I only served for 13 months. I was moved with other staff, including [name omitted] section head who initiated and managed the HWI information system. The development [of the HWI unit] eventually faltered. The continuity and sustainability [of the program] was inhibited. (RI027, tax official)

One prominent tax consultant predicted the future and accomplishment of the HWI unit would not be different from that of the current LTOs: the HWI unit might be a promising initiative in its first few years, but then it would fall back into the ‘business as usual’ mode of the DGT. This is considered as an ‘internal weakness’ of the DGT, as a respondent from a tax consultancy group described.

Another obstacle is the pattern of staff rotation. People who have started to mature [in terms of their knowledge]; three years engaged in an area, for instance, they will be rotated ... I see this as one of the internal weaknesses [of the DGT]. (RI023, tax consultant)

In summary, quick staff rotation, designed to prevent collusion and corruption, had the consequences of denying DGT staff time to learn about the HWI program and its clients. Consequently, the expertise needed to enable the HWI initiative to meet its potential and prove its value within DGT never materialised. The mechanism of staff rotation undermined the HWI unit’s capacity to realise the goals articulated by the former Director General who presided over the unit between May 2009 and July 2009.

### **6.3 Discussion and analysis**

The hypotheses that guided this chapter were:

*Hypothesis 3(a): Learning about implementation of the HWI policy requires understanding of the principles underlying the policy (particularly as enacted in Australia).*

*Hypothesis 3(b): An understanding of the principles underlying the HWI policy is essential for choosing appropriate mechanisms for its implementation.*



However, the fieldwork revealed a more complex state of affairs. Due to a change in the leadership of the DGT<sup>89</sup>, the HWI unit's principles and mechanisms were contested. Learning and understanding were not absent among staff of the HWI unit – they were very aware of what was happening to their unit and why, but their capacity to use their knowledge to affect the contestation was limited. In the first few years of the HWI unit, two DGT leaders held very divergent views about the principles that should guide it, and had no coherent plan to bring together different parts of DGT in the new HWI regime. The absence of a meta-principle meant that mechanisms did not have a noble purpose for the DGT as a whole – they constituted commands from above that had to be followed. Meaning-making through the innovation was confused in a way that was demoralising for staff.

The evidence presented in this chapter points to two major conclusions about the contestation of principles and mechanisms in the implementation of the HWI policy in Indonesia. First, Director Generals as influential actors may have different interpretations of the HWI policy. They assign meaning to the policy and instigate actions and mechanisms that mean that the same policy can be implemented in different ways under different leadership regimes. In the first period of the HWI unit's operation (May 2009–July 2009), the guiding principle was relationship improvement and information gathering for an HWI database which could be used subsequently for compliance work. In the second period (July 2009–January 2011), the guiding principle was meeting revenue targets; this saw the mechanism of a taxpayer database sidelined,

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<sup>89</sup> The former Director General was appointed as the Governor of the Central Bank of Indonesia (Bank of Indonesia).

the special status of the HWI unit discarded, and the resurgence of the mechanism of quick staff rotation, which had the effect of undermining HWI staff's skill and expertise.

The second finding from the evidence presented in this chapter is that absence of documentation that outlined principles for how the HWI unit should operate and what it should achieve meant that the HWI unit was held hostage to the personal preferences of DGT leaders. I detailed a contest of principles among powerful actors within the DGT which heralded changes in operational procedures and thwarted the development of the HWI unit.

HWI policy should be supported by higher-order principles that mean that contested principles need to be debated publicly, rather than traded as power changes hands. The Indonesian HWI policy could have been planned with commitment to principles such as 'maintaining confidence of the taxpaying community in the tax system', 'maintaining integrity of the tax system', 'increasing accountability', 'promoting holism in understanding HWI taxpaying performance', or 'implementing a sustainable HWI program' in order to ensure the policy was regarded by all as having a long-term perspective. These higher-order principles were (and remain) evident in the operation of Australia's HWI program. Australia implemented its HWI program with a set of mechanisms that would ensure its growth, such as the adoption of a holistic approach in monitoring HWIs and their related entities, assigning priority to the HWI unit so that it could effectively and efficiently access cooperation from other business lines, and retaining staff longer than normal to build expertise and accumulate knowledge.

In the Indonesian context, failure to understand these higher-order principles was arguably linked to the imperative to establish the policy very rapidly (discussed in Chapter 5). When a country seeks to adopt a new program from elsewhere, it should understand the principles the organisation responsible for running the program will be required to follow to accommodate actions and give meaning and purpose to them. The Indonesian tax system's short-sighted revenue orientation contributed to the failure to understand the principles of the HWI program. Collecting more revenue from HWI taxpayers and their related entities is a logical consequence when the tax compliance of HWIs and their entities is improved, but the realisation of this goal required more time than was permitted. In order to achieve higher-order principles, HWI policy should be understood as a long-term program. Contestation of principles held by influential actors in the first two periods of implementation of the HWI unit in Indonesia suggested that applied mechanisms were determined by how influential actors interpreted the HWI policy.

Politics is one possible explanation for the favouring of old mechanisms that undermined the effectiveness of the Indonesian HWI unit. The political battles associated with the HWI unit and in the government more broadly are not the subject of this thesis. Nevertheless, on the basis of the fieldwork, it would be negligent to ignore a possible political factor. There might have been a political (either internal or external to DGT) decision to ensure that the HWI unit did not function optimally. If the unit was unable to function well, Indonesia's HWI unit would be unable to uncover the poor taxpaying performance of HWIs, who were also political leaders or had strong relationships with past or present politicians, government officials, or military personnel. Possibly shortfalls in learning how to introduce the lessons of the HWI unit

were connected to the power struggles that occurred at higher levels of government. If decisions were taking place at this level, senior officials in DGT would have been wary of putting into practice opportunities for trial and error adjustments and adaptation to suit the Indonesian context.

## **Conclusion**

This chapter postulated that learning about implementation of the HWI policy requires understanding of its underlying principles. This understanding is essential for choosing appropriate mechanisms for policy implementation. Nevertheless, the evidence I gathered about the implementation of the HWI unit in Indonesia suggested that understanding principles and choosing appropriate mechanisms are not the only factors that predict success. In the Indonesian context, influential actors were important in determining the manner of implementation of the HWI unit.

In this chapter, I argue that lack of commitment to clear and coherent principles and competing or contested principles held by influential actors largely determined which mechanisms were promoted and allowed to continue without interference. The problem was multiplied by the absence of a written policy strategy. This meant that the policy direction could be changed dramatically following change in the top leadership positions. Actors in leadership positions interpreted the HWI policy idea very differently. Based on their interpretation of the policy, different directions were pursued. In an immature public organisation such as the DGT, without an established system of procedures and protocols, the personal interests of influential actors prevail in giving meaning to policy. These powerful actors use their authority to influence their subordinates to accept their interpretation of a policy and set in place the mechanisms to achieve their desired ends.

The tendency of DGT's leaders to preserve old practices reflected a poor understanding of the scope of change and time that was required to a new policy for HWIs. Timing proved to be a crucial factor in implementing the HWI initiative. Lessons learnt from Australia's HWI Taskforce show that the organisation and actors involved in the implementation of an HWI policy must be given time to accumulate the knowledge and expertise necessary for achieving their policy goals.

In the next chapter I provide examples of how these two Director Generals during implementation of the HWI unit in Indonesia used webs of influence to achieve their goals.



# Chapter 7

## The Use of Webs of Control in Implementing HWI Policy, and the Implications

*...strategically, most actors ... prefer to work through dialogue before they resort to laying strands of reward and coercion.*

(Braithwaite & Drahos 2000, p. 552)

### **Introduction**

In the previous chapter I identified sources of failure in the implementation of the HWI initiative in Indonesian tax administration. These include failure to deal with contesting principles and find a higher-order principle to underpin the HWI policy, failure to properly consider which mechanisms were appropriate and which were not for achieving policy goals, and allowing too little time frame for the organisation and actors to learn and accumulate knowledge. These problems were exacerbated, if not caused, by the absence of a written strategy that set out the purpose and reasons for the policy and of the procedures and processes needed to achieve the desired outcomes. In the absence of such documentation (which should have been widely distributed and publicly available), the interests of powerful actors (DGT leaders) strongly influenced the policy

direction of the Indonesian HWI initiative. Mechanisms chosen to achieve policy goals changed according to influential state actors' desires, without consultation or discussion with those affected.

This chapter presents a picture of the social dynamics that occurred in the DGT during the implementation of the HWI policy in Indonesia. I argue that vertical and horizontal communication among actors is an important part of the process of implementing a new policy such as an HWI initiative, particularly if the policy is adopted from another country and requires substantial adjustment to fit local context. Communication that reaches all parts of the organisation facilitates explanation and constructive dialogue about the purpose of the new policy, how it is to operate, and the resources available to support its operation. Furthermore, continuing dialogue with policy stakeholders facilitates the organisation's capacity to respond to problems that occur in implementation and promotes continuous learning about how to effectively run the program in a new context.

This chapter consists of three parts. In the first part, the concept of webs of influence (Braithwaite & Drahos 2000, chap. 23) is used to explain actors' efforts to achieve their goals. Webs of influence include webs of control (using rewards and coercion to elicit compliance with a course of action) and webs of dialogue (using persuasion and education to win support for a course of action). While webs of dialogue provide more space for involved actors to participate in the process of policy implementation through formal and informal channels of communication, webs of controls place considerably less importance on debate and persuasion, particularly at lower levels of an organisation. Webs of control reward those who comply with influential actors'



directions and coerce or threaten those who do not (Braithwaite & Drahos 2000, pp. 557–558).

In the second part, this chapter presents empirical evidence about the quality of communication between actors in strategic positions in DGT and those at the operational level. Many external stakeholders were also neglected when the HWI initiative was implemented in Indonesia. Lessons from the implementation of Australia's HWI initiative showed that communication with policy stakeholders is pivotal. The ATO was able to learn from outside actors (e.g., tax practitioners, tax law consultants, financial advisers) on how the tax authority might best utilise its HWI Taskforce to deal with HWIs' tax affairs (Braithwaite 2001, p. 255). (In this regard, note that 'Taskforce' originally described a planning and problem solving group that comprised knowledgeable and important stakeholders within and outside the ATO (ATO 2008, p. 9)).

Implementation of a 'foreign' policy requires understanding of local contexts. Actors whose jobs bring them in contact with the everyday reality of taxpaying and tax collecting understand the context more than those who inhabit the corridors of power of political and civil service decision-making. Learning from tax officials, advisers and taxpayers could produce knowledge on how a policy should be adapted in a different situation. Communication with stakeholders within and outside the organisation is also important to elicit commitment and support. The last part of the chapter examines the importance of winning support for new policies in local contexts.

## **7.1 Powerful actors' use of webs of influence**

In the context of globalisation of regulation, Braithwaite and Drahos (2000) argued that '[d]ialogic webs are more fundamentally webs of persuasion than webs of control' (p. 553). In dialogic webs, they suggested, actors from different backgrounds have opportunities to convene with each other officially and unofficially, formally and informally. Through these meetings and conversations, they define their interests, clarifying them for their own purposes and communicating them clearly so that they are understood by others.

The following sections demonstrate that various actors employed webs of dialogue and webs of control at different periods of the implementation of the HWI initiative in Indonesia. When the HWI unit was initially being considered as a quick-impact program, it seemed that influential actors used a dialogic approach to disseminate the policy idea to stakeholders: internally to staff at the operational level, externally to taxpayers and their advisers (although it should be noted that the use of dialogue at this period was limited and not exactly open). Dialogue closed down further as the HWI unit swung into action, and had disappeared completely by the time the DGT's leadership changed (see Chapter 6). The next episode of the Indonesian HWI unit's operation was coloured by the use of webs of control to revert to old ways of operating and to meet the interests of influential actors.

### **7.1.1 Webs of dialogue initially, but limited in scope**

The first form of persuasion delivered by dialogic webs is 'issue definition' (Braithwaite & Drahos 2000, p. 553). According to Braithwaite and Drahos, influential actors utilise their position to define the crucial issue that requires actions. What is

defined as crucial may differ from one actor to another, depending how actors understand and give meaning to the policy. Once the issue has been defined, dialogue follows in order to redefine the interests of actors in solving the problem. Through this process, stakeholders are given opportunities to cooperate in solving the problem.

In the context of implementation of the HWI policy in Indonesia, some actors saw multiple issues as connected, other actors less so. The crucial issues that required action were providing wealthy taxpayers with better assistance to fulfil their tax obligations, restoring trust in the tax authority, and improving relationships with taxpayers, or generating revenue from HWI taxpayers through compliance activities so that Indonesia's tax revenue turned from being dominated by corporate income tax to being predominantly based on personal income tax. Which issue should have been prioritised as the crucial issue differed from one influential actor to another and from one time to another.

#### *Dialogue with internal actors*

In the initial period of the HWI unit in Indonesia, from the time the unit was established until the Director General was replaced, the driving force was concern that tax compliance of the very wealthy was extremely low. This problem required attention from the DGT and needed to be resolved. One high-ranking official in DGT spoke of as the critical reason behind the concept of the HWI unit.

I saw a list of tax payments of the wealthy, whose assets amount to trillions [Rupiah], [their tax payments] are very small; smaller than my payments. (RI038, former tax official)

However, actors in strategic positions in the DGT realised that this issue could not be disclosed publicly. Low public trust in the tax authority at that time meant that any acknowledgement of a problem with the taxpaying of the wealthy would reflect unfavourably on DGT's performance (RI037, tax official). The public in general and HWIs in particular would have demanded that the DGT improve its performance before taxpayers were asked to be compliant with their tax obligations.

At the same time, political forces urging the DGT to take a new approach to HWIs were quite strong, as reflected in the opinions of these informants, both from outside DGT:

Rich people should be given service differently [from general taxpayers]. (RI011, other organisation)

They have contributed to this Republic, why are they treated the same as people in general? [Service for them] must be different. (RI016, other organisation)

In order to minimise political pressure on the DGT, the strategy chosen by the DGT and the MoF was to restrict discussion of the issue of tax compliance of HWIs to being for 'internal use only'. Disclosing this issue to the public while the public's trust in DGT was low (and political pressures to cooperate with HWIs were high) would have been counterproductive to the sustainability of the program (RI037, former tax official). As mentioned in Chapter 6, at this early period, the DGT leadership recognised that the HWI initiative had to be a long-term policy. The principles of 'relationships improvement first, and revenue collection later' captured the strategic thinking of the leadership in this early period.

Defining the issue of HWI compliance internally within DGT could be seen as influential actors defining their crucial issue through persuasion. Actors in strategic

positions sought to develop the same commitment and mutual understanding of shared interests between actors at different levels in the DGT. An informant who was a tax official at the time recalled his experience of having meetings at MoF and DGT headquarters in which the Finance Minister raised concerns about the tax compliance behaviour of the very wealthy:

I attended two meetings with the Finance Minister [something that rarely happened to echelon IV staff]. Actually, we were even invited into three meetings with the Minister [but the respondent only attended two meetings]. In the meeting, the Minister raised the issue that she understood there were a lot of wealthy people who could afford to buy luxury cars but paid very little tax ... Therefore, the rich became the target of this program [to improve their compliance] ... The idea [for setting up an HWI unit] was originally like that. (RI002, tax official)

Dialogue between staff at the HWI unit and higher-level officials in the MoF and DGT not only occurred in relation to defining the crucial issue, but continued until the HWI unit had been running for several months. In this period (May-December 2009), staff discussed the development of the unit on many occasions (RI022, tax official). Involvement of staff at the operational level, in the form of formal and informal meetings with both LTRO and headquarters, contributed to the flow of ideas from actors on the ground: what information system was required to support their works; what regulation needed to be reviewed to deal with HWIs; how to deal with bureaucracy when requesting taxpayers' data; or what training was needed for the staff. A paper produced by staff at the HWI unit (Indonesia HWI Unit 2010), which discussed problems they encountered in the first few months of the HWI unit operation and suggestions for improvement, was only theoretical and could only be distributed in a dialogic climate.

In the early period of the HWI unit's operation [i.e., before the Director General was replaced], we had relatively intensive dialogue with the headquarters and *kanwil*. We provided a lot of feedback about the SOPs [standard operating procedures], how the HWI unit should operate [and] constraints we faced on the ground. We even produced a special report and gave it to headquarters, something that no other TSO had done before. (RI024, tax official)

Section heads had routine meetings to discuss problems we faced in our jobs ... there was no gap between sections [in this HWI office] as we often heard in other offices. We delineated the problems and advised headquarters. (RI027, tax official)

### *Dialogue with outside stakeholders*

In the first period of implementation of the HWI unit, the DGT sought to use dialogic webs with stakeholders outside the organisation such as tax advisers, lawyers, accountants, and business or investment consultants. Involving these actors in the effort to influence tax compliance of HWIs was a mechanism that the ATO pursued during its HWI taskforce operation (Braithwaite & Braithwaite 2001, p. 418).

In Indonesia, however, dialogic webs did not function optimally as a means for delivering policy ideas to stakeholders outside the DGT. These kinds of forums functioned more as a means to introduce or explain technical aspects of taxation, such as how to lodge tax returns online, the meaning of new tax regulations, or how to deal with tax auditing (HWI TSO 2010b), rather than forums to discuss strategic issues. Even when strategic issues were discussed (e.g., what the HWI unit's objective was), the DGT introduced the HWI initiative as a new way of delivering service to wealthy taxpayers (discussed in Chapter 6) rather than as a new regulatory approach for monitoring the compliance of this taxpayer group. Consequently, their understanding of

the policy was low, which resulted in misperception and even scepticism about it. Tax advisers were sceptical about the genuine intention of the policy:

We had negative experiences [with the DGT] ... the DGT always spoke ambiguously ... they had a hidden agenda [with this unit]' (RI005, tax consultant).

The HWI unit? I think it is like 'hunting in the zoo'. (RI003, tax consultant)

By 'hunting in the zoo'<sup>90</sup>, RI003 meant that DGT would exploit HWIs for generating revenue rather than provide them with a better service (as per the HWI unit's publicly stated objective). The public in general and taxpaying community in particular did not believe that this was the HWI unit's true purpose. Although DGT sought to develop dialogue with actors from outside DGT, such dialogic forums did not function to deliver new policy ideas, let alone gain shared commitment and support.

Dialogue with outside was different from that with internal stakeholders. DGT was under political pressure not to disclose the real objectives of the HWI policy. HWIs are people with economic and political power; their connections with political parties, senior government officials and high-ranking military personnel placed them in advantageous positions in relation to DGT. The HWI policy did not receive strong political support, possibly because it was defined as a 'DGT program' rather than a 'government program' (RI018, RI034, tax officials).

As a DGT program, the HWI initiative was hobbled by the public's long-held perception about DGT as a 'corrupt institution' (World Bank 2003). DGT failed to disclose openly the reasons behind the establishment of the HWI policy and its

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<sup>90</sup> This expression is equivalent to the better-known English expression 'shooting fish in a barrel'.

objectives. Hence, it fed public suspicion despite efforts made by DGT leaders to develop communication with taxpayers and their advisers.

Communication within DGT was more successful. This was acknowledged by an IMF advisor to DGT, who reported that frequent discussion and communication among various DGT directorates with a stake in the HWI initiative was quite intensive in this period (IMF 2011, p. 14). Nevertheless, these kinds of internal communication forums were not yet institutionalised in the DGT; rather, meetings occurred on an ad hoc basis. No special group met regularly to discuss problems in relation to the implementation of the HWI unit. Formal regular meetings, such as the national leadership meetings (*rapimnas*)<sup>91</sup> and the regional coordination meetings (*rakorda*)<sup>92</sup> functioned mostly as one-way top-down communication, in which the Director General (in a *rapimnas*) and the *kanwil* chief (in a *rakorda*) disseminated instructions to subordinates officials on new initiatives (new rules, practices). These forums were also the occasion for units' (regional offices or TSOs) performance evaluations, at which units' revenue collections were compared and ranked.

The absence of institutionalised forums involving internal actors within the DGT and outside stakeholders contrasts with the ATO's arrangements for their HWIs. DGT did not have a special group such as the National Tax Liaison Group (in Australia) (ATO 2012) in which senior tax officials, particularly from the HWI unit, met with tax practitioners to discuss particular issues relating to HWIs, or The Wealthy Forum (HM

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<sup>91</sup> The national leadership meeting or *rapimnas* is a regular meeting held by DGT headquarters and attended by all directors at DGT headquarters and *kanwil* chiefs across Indonesia.

<sup>92</sup> The regional coordination meeting or *rakorda* is a regular meeting held by a particular DGT regional office (*kanwil*) led by the *kanwil* chief and attended by TSOs' chiefs under supervision of certain *kanwil*.



Revenue & Customs 2010) in which tax advisers from the UK's big accounting firms meet regularly with senior members of HMRC's HWI unit to discuss issues such as compliance risks, customer service and consultation on proposed policy changes that affect wealthy taxpayers. Such a forum can also be used to signal to the taxpaying community which practices will become the tax authority's focus: '[In that forum] you tell them what attracted your attention' (RA007, tax official).

Following the replacement of the DGT's leader, relationships that were being built between actors internally and externally changed dramatically.

### **7.1.2 Webs of control after July 2009**

#### *Reward and coercion of HWI unit staff*

As reported in Chapter 6, the DGT leadership change sparked 'a totally 180-degree turn' in policy direction (RI024, tax official). Not only was the policy focus and direction changed, relationships between headquarters and the HWI unit and its staff changed as well. Instead of achieving the long-term goal of improving compliance of individual taxpayers by using wealthy taxpayers as role models, the priority reverted to the short-term goal of annual revenue target achievement.

An IMF report revealed that 'changes in leadership and program focus have impacted the advancement of the HWI program' (IMF 2011, p. 14). Leadership change disrupted the previously shared interest among involved actors. Dialogic webs among internal stakeholders were used less. Powerful actors who wanted to achieve their objectives hurriedly utilised a different strategy: webs of control (using reward and coercion) to ensure that actors in subordinate positions had no choice but to follow the DGT leader's

new directions. Staff knew the consequence if they did not comply with the directions from the top.

The use of rewards and punishments can encourage the accomplishment of short-term goals. Coercion, as seen in the second period of the HWI unit's operation, took the form of being rotated to other TSOs in less favourable areas, or deployment to a lower grade position, or being ridiculed in *rakorda* or *rapimnas* meetings. These measures pushed staff into generating more tax revenue in the short term. One informant described how the HWI unit staff were under more pressure in this period:

‘[because revenue of the HWI unit was insignificant] we were always scolded when he [Director General] came here [the HWI unit] or in the [formal] meetings’ (RI024, tax official).

This informant continued:

‘... we were always being demanded to perform compliance activities [in order to generate more revenue] ... no matter what’.

Some operational staff resisted the new Director General's direction. First, the HWI unit staff understood the original intention underlying the HWI policy was that compliance activities were not the priority, at least in the first few years of operation. Second, infrastructure to support compliance activities (e.g., taxpayer databases, risk assessment method and operating procedures) was not yet available. Third, staff at the HWI unit did not have the experience necessary to effectively audit HWI taxpayers (IMF 2011, p. 14). As suggested by one IMF advisor to the DGT, staff at the HWI unit required more time

to accumulate knowledge of taxpayers' complex financial arrangements, tax planning techniques, and association with related entities (IMF 2011, p. 10).

In these circumstances, using a coercive approach to secure compliance from lower-level staff meant that staff felt they were treated unfairly; their ideas and suggestions were no longer heard and problems they faced were not supported. Staff on the ground started to demonstrate attitudes of helplessness and passive resistance, as the following respondents revealed:

We were in a very difficult position ... you know what I mean? ... If we followed DG's [Director General] instruction [to do compliance activities at this stage] we had no sufficient capability [expertise, data, and experience for doing audit to HWIs]. If we did not follow his direction we would be punished [and perceived to be underperforming]. (RI019, tax official)

What can we do [with this situation]? We had no choice but follow the instruction [to do auditing]. (RI025, tax official)

The new DGT leader did not take these conditions into account when he asserted that the HWI units should generate more revenue through compliance activities. The priority was that every unit (TSOs) – including the HWI unit – should achieve the nominated revenue targets with their available resources. Actors on the ground were not given opportunities to share their ideas about what should be prioritised. Communication and dialogic webs that had been developed in the previous period were shattered.

Passive resistance was visible among HWI unit staff. They '...started to be demotivated' (RI025, tax official), and grew anxious about their careers and positions (RI024, tax official).

From conversations with staff at the HWI unit during my fieldwork from January 2012 until February 2012, I understood that one reason staff were demoralised after a sudden change in HWI policy direction was that they had had high expectations of the HWI unit becoming a new regulatory model for improving tax compliance in Indonesia. If this new model had been successfully implemented, according to staff in the HWI unit, DGT could have used it in other regional offices and HWI staff would have been part of that success. One tax official expressed the sentiment in this way:

During the previous leadership, at the time the HWI unit was established, as far as I understood the mission of the establishment of this unit was to create a kind of laboratory for DGT [for administering taxpayers with complex transactions] and we were proud of being part of such an experiment. (RI027, tax official)

When channels of communication closed down during the second period of the HWI unit's operation, staff did not know what they should do, as the above informant explained further:

The idea was originally like that, but when the leadership changed, suddenly we had to change the orientation [meeting the targets]. Well ... that's what made us so desperate ... you know what I mean? (RI027, tax official)

The above opinion is consistent with the following respondent's view about his and his colleagues' feeling: 'We started wavering because the orientation of the unit was changed [suddenly]' (RI024, tax official).

It was not only actors in the HWI unit who felt confused about what was going on; even people in DGT headquarters and LTRO who supervised the work of the HWI unit were uncertain. An informant who was involved at the beginning of setting up the HWI unit,

but subsequently left the DGT, spoke to me about the development of the HWI unit following the leadership change.

[How this unit operated] was returning to the old model [of how DGT offices operated], if I may say I was quite disappointed with the development of this office. (RI038, former tax official)

The respondent was disappointed because the way in which the HWI unit operating was not as it had been expected in terms of using innovative approaches to monitor tax compliance of HWIs and their related entities such as those practised in Australia and other developed countries.

#### *Changing relationships with outside stakeholders*

Dialogic webs that had developed with stakeholders outside the organisation during the first period of the HWI unit's operation also weakened in the second period. Dialogic relationships between DGT and outside stakeholders, although limited in scope, started to flourish in the first few months of the HWI unit's operation. In this period, tax officials and advisers met (in some cases) in an equal, supportive and communicative environment. Staff communicated with tax advisers and taxpayers to introduce the HWI program, provide assistance in relation to tax return lodgements, or respond to taxpayers' inquiries (HWI TSO 2010, pp. 29–32).

Changing the focus of the HWI unit's operation to compliance activities changed relationships of dialogue into 'confrontational' relationships. Advisers met tax officials not as policy stakeholders who could give feedback to the policy but while representing taxpayers in audit activities.

Yes ... it [relationship with taxpayers and tax advisers] was changed dramatically following changes in policy direction and they could feel the change. (RI019, tax official)

The change in relationships accompanied change toward a stronger compliance and revenue focus. According to one tax adviser, the revenue orientation changed the function of audit:

The taxpayer was annoyed. Audit, for example ... Audit should be carried out to examine whether the taxpayer have followed the rules ... What happened was that the audit functioned to generate revenue. Audit was given [revenue] targets. (RI003, tax adviser)

Stakeholders from outside DGT were also confused about what had happened with the HWI unit. To some extent, the sudden change in orientation to compliance activities confirmed suspicions about DGT's untrustworthiness. They saw the gap between what had been said publicly and what actually been done. As mentioned earlier, actors from the taxpaying community perceived DGT to have a hidden agenda with respect to the HWI unit.

We are confused by the HWI policy. DGT was inconsistent in running the policy ... we had such an experience in the past. (RI005, tax adviser)

HWI taxpayers also felt confused, especially after they realised that the HWI unit was similar to the TSOs which had originally administered them. A respondent from the HWI unit explained his designated taxpayers' reaction in this way:

... many of them [taxpayers] assumed that they would be caught, put in a 'cage' – using their terminology – and ready to be slaughtered at any time. (RI002, tax official)

The views of taxpayers, as related by the tax official above, were in the context of DGT headquarters inviting potential HWI taxpayers to a series of meetings prior to the

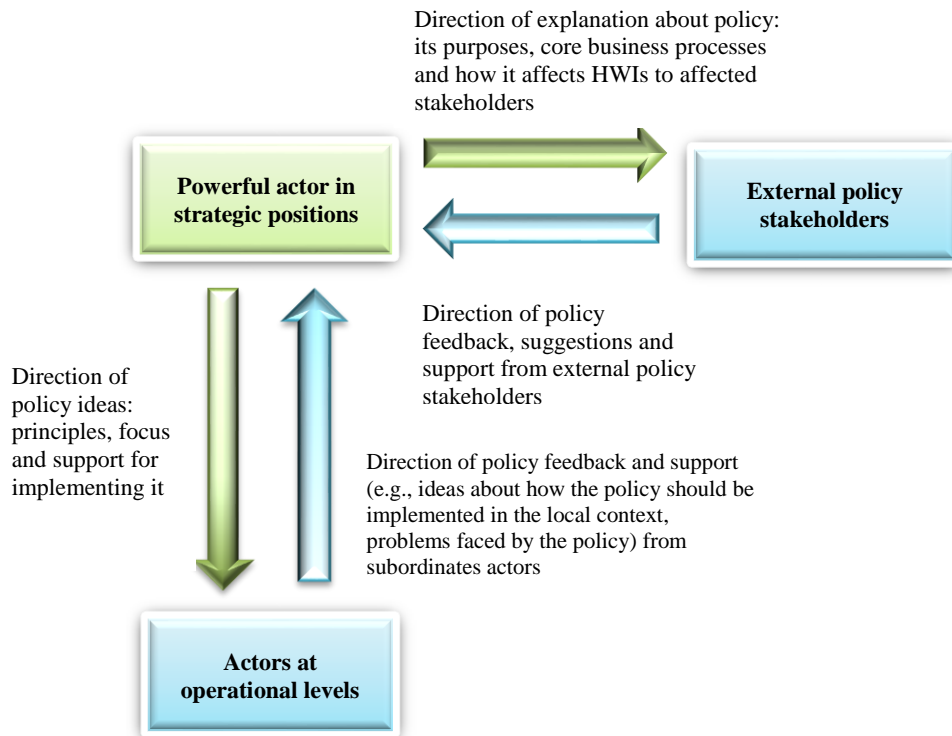
establishment of the HWI unit.<sup>93</sup> They were told that when their tax administration was moved from STOs around Jakarta to the new HWI unit, they would be provided with a better service (RI020, RI030, tax official and former tax official respectively). The inconsistency with actual practice did not go unnoticed by HWIs and their advisers. Any new trusting relationships that were being built with outside stakeholders subsequently disintegrated.

## **7.2 The importance of communication with stakeholders in implementation of HWI policy**

Communication among involved actors is a key element in the implementation of a new policy. Communication facilitates vertical and horizontal flows of information (see Figure 7.1). First, it conveys a policy idea from the top to the bottom of the organisation (vertically) and from the organisation to external policy stakeholders (horizontally) (represented by green arrows). Delivering the policy idea through dialogic strands ensures that it is understood evenly throughout the organisation and by stakeholders to whom this policy is intended for. Lessons from the introduction of the Australian compliance model in early 1997 (Chapter 4) demonstrated that this approach was an effective way to gain support from affected actors, even when resistance existed in some parts of the organisation and external stakeholders.

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<sup>93</sup> The meetings were held on 25-26 November 2008 and 1-3 December 2008 as revealed in an anonymous DGT document (Formation process of the HWI unit 2011).



**Figure 7.1 Two-way dialogue**

A new policy might at first be opposed by some members of an organisation and other stakeholders, but consistent dialogue involves stakeholders in a process of learning and adaptation. Dialogue enables actors to learn policy goals and what the organisation expects from them. Following dialogue with involved actors, policy goals may be adjusted to suit the current situation and resource availability. The policy is adapted in response to consideration of voices from the front line. As long as this adjustment is part of a dialogue involving all stakeholders, conflict can be minimised.

The second flow of communication in Figure 7.1 (represented by blue arrows) are from the bottom to the top of the organisation (vertically) and from external stakeholders to the organisation (horizontally). Dialogue allows actors on the ground and other



stakeholders to provide feedback about how to implement the policy in a more ‘vernacularised’ (Merry 2006b) way, in keeping with local conditions. It is possible because those working with HWI taxpayers have grounded knowledge based on their experiences. A bottom-up flow of knowledge allows actors in strategic positions to learn from what happens in reality when the policy is implemented. This knowledge can be used to improve the policy when necessary. Figure 7.1 illustrates the two-way direction of dialogue in policy implementation (vertically and horizontally), which is how the webs of influence should have been working in the policy implementation stage in DGT. Braithwaite and Drahos (Braithwaite & Drahos 2000, p. 557) noted that all the interconnections previously developed through dialogic processes could be weakened by threats of coercion.

The following sections detail the consequences produced by the use of webs of control when the DGT implemented the HWI initiative.

### **7.2.1 Unheard voices from the ground: blocked channels of communication**

Actors on the front line, particularly those in the HWI unit, were concerned about how the policy was handled after the leadership change but reluctant to express their opinions. The new culture developed in the HWI unit, where lower-level staff had opportunity to provide advice through formal and informal channels to senior staff, also stopped. HWI staff recognised changed communication practices as a problem (RI019, RI025, RI031, tax officials).

When staff at the HWI unit realised that, due to their structural level in the DGT organisation, they had no authority to force other TSOs and other government agencies

to provide them with the HWI information they needed, their hope was that headquarters would take over this role. According to one informant:

Due to the nature of HWIs and their entities, our suggestion was that this role [data gathering] was played by a higher-level office, either *kanwil* or headquarters (RI024, tax official).

Unfortunately, as another respondent recalled: ‘we lacked support from headquarters’ (RI025, tax official). HWI staff felt they had little choice but do as they were told (RI009, tax official). They preferred not to reveal the difficulties they faced in the field because if they did so, they would be seen as grumbling or labelled as non-performers.

The use of webs of control not only blocked channels of communication between higher- and lower-level officials (especially those at the HWI unit), but also with stakeholders involved in the implementation of and affected by the HWI initiative. One respondent commented that communication was essential but was not given much attention (RI008, tax consultant). What the respondent meant was that communication between DGT as policymaker and policy stakeholders in relation to how the HWI unit should operate (such as that of the LTO in early 2000s) would not happen again.<sup>94</sup>

### **7.2.2 Lack of support and missed opportunities to learn from actors on the ground**

Since the HWI initiative in Indonesia was transferred from Australia, a country which is structurally different from Indonesia, the transferred HWI policy needed to be adjusted in terms of how it should be operationalized to make it fit the Indonesian context. Actors on the ground translated the foreign ideas about how to effectively manage the

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<sup>94</sup> That is, the newly developed ethos of the HWI unit would not continue and it would be business as usual in DGT (RI001, tax consultant).

tax compliance of HWI taxpayers, not the epistemic community of taxation policy experts (e.g., IMF advisors, World Bank consultants, and tax experts in the FTA) who had spread the idea globally. Global actors did not have sufficient knowledge about local contexts such as Indonesia's taxpaying culture or organisational constraints. When it came to implementation of the policy, the distance between global actors and local context was too wide.

As translators of HWI ideas on the ground, staff in the HWI unit had advantage. They understood the problems they faced when dealing with Indonesian taxpayers in general and HWIs in particular. This knowledge could only be obtained through interaction with the Indonesian taxpaying community – experience that tax experts from epistemic communities did not have. The HWI staff who had undergone training and skill development tried to shorten the distance between the HWI initiative global practice and Indonesian context. However, their input was ignored or rejected.

The lack of success in translation of the HWI policy in Indonesia was in part due to a tradition of poor communication within and from the DGT. Actors in high-level strategic positions were not in the habit of talking to officials in low-level operational positions about problems, except in the brief first period of HWI unit implementation (see Figure 7.1). Staff in the HWI unit tried to introduce mechanisms that they thought were suitable within the Indonesian context. However, the idea of integrating HWI taxpayers' databases and their related entities (as discussed in Chapter 6), for instance, was rejected by powerful actors as it was considered as 'not in accordance with the existing rule' (RI021, tax official).

Instead of developing windows of opportunity for dialogue and learning about the idea introduced by the HWI staff, powerful actors interpreted the actions of their subordinates as being against the directive of DGT headquarters.<sup>95</sup> The result was not surprising. The person responsible for the idea of integrating data about HWIs and their related entities was transferred to another TSO after less than 13 months in the unit (RI027, tax official). Powerful actors used their power to silence those who did not comply.

If dialogic webs had been used, a compromise solution might have been found without sacrificing the existing rules, as an informant expressed his idea (RI025, tax official) as follows. This tax official suggested that one solution might have been to allow the HWI unit list entities that were linked to a particular HWI. Based on such lists, headquarters could either grant the HWI unit limited access to the data of HWI-related entities, or alternatively provide ready-to-use data in relation to HWI-related entities without granting the HWI unit access to taxpayers' database. This seemingly simple solution did not come to the surface because communication did not flow smoothly in both directions.

Apart from being an obstacle to the use of knowledge from actors on the ground, the blocked channels of communication were demoralising. Staff of the HWI unit perceived that powerful actors did not support or appreciate their work (RI021 and RI025, tax officials).

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<sup>95</sup> This was suggested from conversation with informants who asked not to be quoted directly.

It is important to recognise that senior officials in the DGT held knowledge and had a perspective that was as important to consider as the views of the HWI unit staff. However, and although such sharing of perspectives was beginning to occur in the first period of the HWI unit's implementation, it never took place in the second period. A shared interest could have been achieved through a written strategy – as already noted in this chapter and in Chapter 6, a crucial element missing from Indonesian HWI policy. A formal written plan or strategy would have facilitated open dialogue among policy stakeholders, established and communicated policy goals and objectives, helped build a consensus for management and direction, and developed a sense of ownership of the program (IMF 2011, pp. 14–15). A revised version of the HWI program could have proceeded in this way.

### **7.2.3 Lack of support and perceived failure from outside stakeholders**

The contrast with the Australian situation at the implementation stage was great. The Australian HWI initiative received much attention from a vast array of actors (e.g., the public in general, politicians and political institutions, and taxpayers' 'networks of influence' (Rawlings 2005) such as tax advisers and accountants). In Indonesia the concepts of the policy were not communicated clearly to the public in general or to actors who had a close relationship with HWIs (such as tax advisers). Consequently, the HWI initiative in Indonesia received little attention or support from actors outside the DGT. The business community thought this initiative meant new taxes or tariffs for HWIs, as did a prominent investment and business adviser who thought that the HWI initiative meant increasing tariffs for wealthy individuals that would cause 'local investors to flee abroad' ('Tax for wealthy taxpayers' 2009).

To avoid controversy and to preserve ambiguity about the function of the HWI unit, the DGT restricted communication. As already noted, involving stakeholders is crucial in every phase of the innovation process (Eggers & Singh 2009), including introducing a new policy into the public sector: from generation phase through implementation of ideas. With respect to the implementation phase of new ideas in the public sector, Sørensen and Torfing (2011, p. 852) have argued that implementation of a new initiative is enhanced when collaboration creates joint ownership of the new initiative. Moreover, they suggested that developing a feeling of ownership among involved actors could reduce resistance to the implementation of the new initiative. This suggests that DGT moved in the wrong direction; more communication was necessary, not less.

DGT should have not only developed vertical communication with internal actors, but enhanced horizontal communication with actors outside the organisation (see Figure 7.1), especially those who have close relationships with HWIs. As in other countries, the tax affairs of HWIs in Indonesia are mostly managed by their advisers (RI002, tax official). Good communication with HWIs' networks of influence at the very early stage of the implementation of the HWI program was vital but missing. Stronger and more transparent webs of dialogue involving outside stakeholders might have minimised resistance and created a feeling joint ownership of the HWI program.<sup>96</sup>

The DGT stood to gain three benefits from developing stronger, more formal dialogue with tax advisers. First, it could have utilised tax advisers to introduce the work of the

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<sup>96</sup> This is not to suggest, however, that dialogue alone would have led to a major increase in HWI compliance. In order to build trust and cooperation, however, DGT should start with an honest explanation about its true motivations when introducing a new policy.

HWI unit, its role and expectations to targeted taxpayers. It is likely that taxpayers would have been more comfortable learning about what the HWI unit was doing from their advisers than directly from the DGT. (That said, formal and honest communication in writing to HWIs may also have enhanced transparency and trust.) Second, because tax advisers often have close relationships with their clients, they may be a better target for improving compliance (Braithwaite & Braithwaite 2001, p. 418). Engaging advisers to influence taxpayers' compliance was an alternative path that DGT could have followed in situations where relational distance between taxpayers and the tax authority was high and adversarial, especially with taxpayers with whom the DGT had previously had serious problems (see Chapter 5, section 5.1.2). Third, good communication networks between tax advisers and DGT could have enabled the HWI unit staff to learn about the tax, business, investment, and financial arrangements employed by the HWIs. More often than not, tax officials lag behind independent tax professionals in their knowledge and understanding of the latest developments in tax minimisation and avoidance, as one respondent from an international organisation suggested:

HWI taxpayers in Indonesia employ sophisticated financial and tax advisors. The DGT should strive to bring the expertise of the HWI office as close as possible to the levels of the taxpayers' advisors. (RI040, international organisation)

When this kind of learning process can be institutionalised in a more formal forum such as practiced in other countries (e.g., Australia and the UK), any issues that arise in the forum can be used to guide proposed policy changes. If such formal engagement had been developed in the early stages of the initiation of the HWI program, a cynical question from one tax adviser such as the following might not be raised:

Did you think that a good policy [such as the HWI initiative] alone could create a conducive environment to improve tax compliance [of HWIs in Indonesia]? (RI031, tax consultant).

Another prominent tax consultant saw the HWI policy in Indonesia as a ‘flawed imitation’ of policies in more developed countries and one that ‘should be terminated’ (RI003, tax consultant). This rejection of the HWI unit might not have happened on such a large scale if DGT had created more space for outside stakeholders to be involved in shaping and evaluating the program.

*Not just communication but self-interest*

Another explanation for poor support of the HWI unit from the HWIs’ networks of influence was that these actors were acting in their self-interest or that of their clients (RI020, RI030, tax officials). They did not want HWIs’ tax affairs touched by the tax authority. In this view, HWIs used political pressure and the lobbying of tax professionals to bring the program down. One respondent endorsed this explanation for why the HWI initiative in Indonesia did not develop well.

Look. The problem that existed in the Indonesian tax system – like any other law in this country – is ... sorry I have to say this ... it is ‘sharp’ when applied to the general public, but ‘blunt’ when applied to the elite. The tax authority does not dare enforce the law against rich people; why? Because the rich people have strong networks, they have political power, and they have lobbies and strong pressure groups. (RI015, academic)

The idea of ‘co-optation’ also arose in conversation with respondents. One respondent from the group of tax officials recognised this as another source of pressure on Indonesia’s HWI program.



You know ... now in the executive, many ministers have backgrounds as businessmen, so it is with the legislators. Do you think they want to see HWI [unit] evolve? It [the HWI program] will open their records [in taxation] ... they are co-opted [by business interests]. (RI018, tax official)

Nevertheless, some of the respondents from the tax practitioners group (including tax lawyers and tax advisers) saw potential in the new HWI unit:

Actually, there was no problem if the government wanted to establish a HWI [unit], because the statistics showed that the number of rich people in Indonesia has increased. Especially if we look at the per capita income of Indonesians, that has also increased. However, the increase in per capita income was uneven, [it was] enjoyed only by a small part of society. (RI006, tax consultant)

I think in this case, the HWI unit allows closed monitoring to HWIs. If the rich taxpayers remained in the TSOs, they would not be monitored properly. By gathering them in one office such as the HWI unit, the hope was that they would be monitored more intensively. (RI026, tax lawyer)

### **7.3 Discussion and analysis**

The hypotheses that guided this chapter relate to the consequences of powerful actors using webs of control to secure their objectives. Webs of control influenced the flows of policy ideas from the top to the bottom of the organisation and of policy feedback in the opposite direction. As a result, knowledge sharing contracted, support was undermined and learning was impoverished.

*Hypothesis 4(a): The use of webs of control rather than webs of dialogue by powerful actors blocked channels of communication across different levels of the organisation and with stakeholders involved in the implementation of and affected by the policy.*

*Hypothesis 4(b): Poor communication to disseminate new policy ideas such as the HWI unit resulted in poor support for the policy and an inability to learn from others with local 'grounded' knowledge for how the policy could be best implemented.*

The fieldwork also revealed an unanticipated phenomenon as the result of powerful actors' preference to use webs of control: a passive resistance.

A change in the leadership of the DGT during HWI unit implementation had far-reaching effects. While I showed in Chapter 6 that change in the DGT leadership resulted in a contestation of principles and mechanisms, evidence presented in this chapter suggests the dialogic webs that had been developed by previous powerful actors were changed dramatically into webs of control by others.

Powerful actors' preferences for using webs of control in order to achieve their goals resulted in reluctance among actors at lower levels to participate, especially in the period of HWI implementation after the DGT leadership changed. The HWI unit staff knew they lacked the means that would enable them to actively participate in the implementation of the policy through an equal and open dialogue. In the first period, they could voice concerns; in the second period, they were silenced. They were denied a forum that would facilitate information sharing and provide feedback in relation to the policy to actors in strategic positions.

When powerful actors used dialogic webs, they increased the degree of inclusion of all stakeholders into discussions and the degree of ownership of the policy. Dialogic webs developed by powerful actors during the first period of the HWI unit's operations provided a greater space for involved actors to engage with each other in a more persuasive, communicative, sometimes contestable but cooperative environment (see description of such space in Braithwaite & Drahos 2000; Cartwright 2011). It should be acknowledged, however, that dialogic webs used for internal actors were different in quality to those used for external actors. Nevertheless, the efforts of powerful actors in this period to initiate and maintain dialogue should not be neglected, given that the increased scope for discussion departed from the DGT tradition of command and control with little transparency.

Actors' preference to use dialogic webs during the first period of the HWI unit's operations could not be separated from the principles held by these actors in relation to the HWI policy. As discussed in Chapter 6, principles accommodate actions that actors choose to take. In the first period, powerful actors gave meaning to the HWI policy as a long-term policy. Therefore actors sought to develop relationships with internal and external stakeholders. Relationship building included external stakeholders, particularly aimed at restoring trust in DGT as an institution and their officials.

Dialogic webs created respectful forms of regulatory management, negotiation and relationship development between actors at different positions, whereas webs of control prioritised the use of command and control regulation with powerful actors dominating weaker ones. Webs of control are mainly used by actors who want to achieve their goals through a short-term commitment while undermining a long-term one (Braithwaite & Drahos 2000, p. 558). The use of coercion or threat of coercion by powerful actors at

the DGT during the second period of the HWI unit's operations showed that while it might bring about compliance among weaker actors on the ground, it also produced negative long-term consequences in terms of capacity-building with staff stakeholders.

The first consequence of using webs of control in the implementation of HWI policy in Indonesia was that it blocked channels of communication, disconnecting actors on the ground from the leadership. This did not result in open confrontation, but actors were reluctant to follow the new leadership. The guiding principles had changed. Confusion reigned.

The second consequence of use of webs of control was that dissemination of the HWI policy idea was poor. Actors on the ground indicated that many stakeholders did not understand or accept the changed policy ideas. This prevented the development of broad-based support for the policy, and powerful actors could not learn from actors who had local grounded knowledge for implementing policy in a more localised way. Actors on the ground chose not to convey their ideas about the HWI unit and preferred to 'do something' that powerful actors asked them to do, even if it did not make much sense to them. They understood the consequences that might follow if they did not comply with orders from above.

As the dialogic environment faded, the HWI policy lost support because stakeholders had different interpretations of it. The interpretations constructed in the first period by the Director General gave rise to mutual commitment and shared interests, especially with internal actors. This embedded understanding could not be replaced instantly by using coercion, because webs of dialogue had established normative commitments. When the webs of dialogue were dismantled, commitment did not immediately change.

Commitment to old understanding co-existed as the new regime swung into action, and confusion resulted.

Blocked dialogic communication channels also led to the loss of opportunities for powerful actors to learn from other stakeholders outside the DGT, in particular tax practitioners, who have rich knowledge about HWIs and their tax and business affairs. These actors, if involved in implementing an HWI initiative through a more institutionalised dialogic forum, could have contributed substantially to the development of the HWI unit.

Two-way communication could have facilitated actors sharing of broad goals and directions with actors on the ground, who in turn could provide actors in strategic positions with feedback about how the policy was working. Their local grounded knowledge might have benefited the HWI policy by drawing attention to limitations in implementation and differences between Indonesia and Australia that affected successful implementation. Dialogic webs of this kind allow for ‘fluidity and interchangeability’ (Cartwright 2011, p. 54) of ideas and knowledge between actors. This is not possible in an environment where less powerful actors are threatened and therefore choose to comply half-heartedly.

## **Conclusion**

This chapter documents how DGT struggled to implement the HWI policy they transferred from Australia. Following the change in DGT leadership, the direction of the HWI unit changed markedly. In this chapter I discussed how relationships were built between involved actors and stakeholders in the first period of the HWI unit and how they changed in the second. The nature of relationships within DGT and with external

stakeholders determined how ideas about the HWI policy were understood, accepted and supported.

I argued in this chapter that powerful actors' tendency to use webs of control rather than webs of dialogue blocks channels of communication. Vertical and horizontal communication across different levels of the organisation and with stakeholders involved in the implementation of and affected by the policy are essential when a new complex policy such as the HWI initiative is introduced. Moreover, I asserted that when communication with involved actors is poorly developed in implementation of a new policy, the policy is unlikely to attract the support needed. A chance to learn from others who have knowledge about how the policy could be best implemented is lost.

The overarching finding from this chapter was that as webs of control crowded out webs of dialogue, passive resistance among internal actors and other stakeholders emerged. With internal actors, passive resistance was demonstrated by following the direction of headquarters half-heartedly, just to show powerful actors that they were 'doing something'. Threats from powerful actors were enough to gain compliance from lower-level staff in the DGT. For stakeholders outside DGT, resistance took the form of cynicism and dismissiveness around DGT's new agenda.

Stakeholders from outside DGT, be they HWI taxpayers or members of their networks of influence, engaged in passive resistance for two possible reasons. One possibility was that these actors were confused about what the HWI policy was about. What was told to them at the outset in the first period was quite different from what was finally experienced in the second period. During the early period of the HWI unit's operation (the first period), outside stakeholders were invited to events at which DGT disclosed its

plan to establish a new regulatory initiative dedicated to HWI taxpayers. Unfortunately, these forums did not achieve their objective of delivering policy ideas to the stakeholders. Stakeholders, based on their experience in the past with DGT, questioned the good intentions behind the plan. When a new Director General came into office and the direction of the DGT changed to revenue collection, relationships with these actors became more confrontational than collegial. This confirmed what these actors had suspected at the outset about the HWI policy.

Politics is the other possible reason why stakeholders from outside DGT demonstrated passive resistance. Again, high politics is not the focus of this thesis; however, my analysis suggested that politics was at play in the discontinuity of the HWI program in Indonesia. Some of the HWIs with tax matters administered in the new unit were affiliated with political parties and institutions. They used their social capital (Bourdieu 1986) to influence political decision-making in relation to the HWI initiative. Further, as pointed out by respondents in this study, many bureaucrats in strategic positions at the time of the HWI unit's early operations came from business backgrounds. They sought to protect their taxpaying history, which could have easily been explored if the HWI unit had operated effectively. While active resistance would have been possible but maybe not sensible, because they would have drawn attention to themselves; they chose to resist passively using their networks of influence.





# Chapter 8

## Conclusions

*If we are ever to think against the pressure of our institutions, this is the hardest place to try, where the resistance is strongest.*

(Douglas 1986, p.113)

### **8.1 Successful innovation, unsuccessful transplantation**

An HWI initiative is a regulatory arrangement used by tax authorities to improve their understanding of the tax and business affairs of wealthy individuals and to enhance their compliance management strategy based on that understanding. This initiative was firstly introduced by France's tax authority in 1983, but did not become popular until it was introduced by the ATO, with a distinctive regulatory approach, in 1996. The policy was then transferred across countries so that by the end of 2013, 17 tax administrations globally had adopted HWI initiatives. This thesis has shown that one reason transfer from Australia occurred is that the evidence had shown that the innovation worked in Australia to varying degrees in the following six ways. After the description of each Australian success, I juxtapose what this thesis found to have happened in the transplantation of the HWI innovation to Indonesia.

1. The Australian HWI program produced early quick audit impacts on an initially small group of HWIs. Success bred success as the number of HWIs included in the program grew from 180 to 2630 (in 2012). Audit takings also grew. By 2013 \$2.8 billion in extra tax had been collected as a result of HWI Taskforce audits (ATO 2012, p. 55).

In Indonesia, in contrast, the politics of reform talked big but failed to start small. Later in this chapter I discuss this failure in terms of the Indonesian political context. Tax officers were overwhelmed by new compliance challenges with a large group of HWIs about which they had little information. The Indonesian HWI unit started its program with 1203 HWI taxpayers. Success did not lead to success; there was no spike in the revenue collected from HWIs that led to sustained growth in the amount of new tax collected over time.

2. In Australia, the HWI program built the legitimacy of the tax system through both major political parties convincing middle and lower income Australians that they should pay their tax obligation voluntarily because special efforts to collect more from the wealthy were now being made.

In Indonesia, the reforms were not justified in terms of making the tax system fairer by getting the rich to pay their share. Rather it was justified in terms of providing a better service to wealthy taxpayers. The wealthy were suspicious of the stated rationale for establishing the unit as being ‘... a manifestation of Government’s appreciation of the wealthy taxpayers who have or should have made a significant contribution to state revenues’ (HWI TSO 2010a, p. 7). Or as said by a member of the House of Representatives:

They have contributed to this Republic, why are they treated the same as people in general? [Service for them] must be different. (RI016, other organisation)

In the Indonesian context, HWIs pointed to the reality that low and middle earners were not even required to lodge a tax return. It was they, the rich, who had served the Republic in such large ways, who were being discriminated against. Hence, quite unlike the Australian outcome, Indonesia failed to increase the legitimacy of the tax system for ‘middle Indonesia’, while it reduced the legitimacy of the system for the rich.

3. Expanded tax returns under the Australian HWI project prevented tax non-compliance before it occurred by reducing the degrees of freedom of wealthy taxpayers in exploiting artificial arrangements.

In Indonesia, the administrative capacity to make this happen was never mobilised. The various reasons for this are discussed later in this chapter, but one revealed in my data was the continuous rotation of staff pursuant to Indonesian anti-corruption policies, before they had time to get on top of the technical complexity of the HWI portfolio.

4. The Australian HWI Taskforce deployed its growing technical command of the affairs of HWIs to propose a variety of law and administrative reforms that also prevented some tax losses.

This did not happen in Indonesia for the same reasons as under point 3. Staff rotating in and out of the Indonesian HWI unit never acquired the technical command of the tax affairs of HWIs to recommend a suite of law and administrative reforms to improve voluntary compliance. Hence, some recommendations provided by the HWI

unit staff, such as designing a special tax return for HWI taxpayers like that in Australia, and developing a special forum with tax practitioners (Indonesia HWI Unit 2010, p. 30–31) had never been accommodated.

5. In addition to the tax collection effect under point 1, these audit impacts delivered a general deterrent effect to reduce tax cheating. No quantitative research in Australia exists that can estimate the size of this effect, but the qualitative research based on interviews with HWI tax advisors and other stakeholders suggest some general deterrence impact of the HWI project (J. Braithwaite 2003b).

Nothing said in the Indonesian interviews for this research suggests a general deterrence effect in Indonesia, as those interviewed did not interpret the extra tax or tax penalties collected by the HWI unit as substantial.

6. In addition to a general deterrence effect of compliance work of the Australian HWI Taskforce, the qualitative Australian evaluations discussed in the thesis suggest some impact of this work in improved voluntary compliance of HWIs, as respondents in John Braithwaite's study revealed (J. Braithwaite 2003b, p. 249).

It's the constant surveillance of being on the program that causes compliance...

Asking the question and getting them to focus their mind on where everything is had an impact.

No such impact is evident in the Indonesian interviews for this thesis. Indonesian tax officers seem to have been too frequently rotated, too demoralised, too resistant to the HWI project for reasons discussed later in the chapter, to be effective in accomplishing improved voluntary compliance by relational regulation.

7. Acknowledging the important role played by tax and law advisors to the tax compliance of HWIs, the Australian HWI Taskforce established a formal consultative forum with stakeholders from this group to discuss compliance risks in relation to wealthy people (ATO 2008, p. 9). More importantly, such a forum served as a channel of communication for the ATO to deliver its message to taxpayers and as the media for the HWI Taskforce officers to learn new things. At the same time, the forum provided opportunities for stakeholders to give feedback and comment on the relevance and impact of the ATO's strategies on compliance risk and tax administration cost (ATO 2008, p. 9).

Such an institutionalised forum was never established in Indonesia. Rather, forums with tax practitioners occurred on an ad hoc basis. None interviewed for this research discussed the importance of involving tax practitioners to improve voluntary compliance of HWIs.

This thesis has contributed to understanding how a taxation policy that was transferred from a more developed country worked in a different form in a new setting – a less developed country. I conducted interviews in Australia to establish benchmarks about the policy. Interviews with various actors in Indonesia helped to understand how those actors interpreted the policy. Interviews were the main method used for gathering actors' narratives (Chapter 3) and were complemented by documentation and archival analysis.

This chapter provides a summary and implications of the findings and their contribution to theory about policy transfer. In the last part of this chapter I present current

developments in Indonesia in relation to the HWI initiative, limitations of the study, and avenues for future research.

## **8.2 The theoretical contributions of the thesis**

Through examining the adoption of an HWI initiative in the Indonesian tax administration this thesis sought to develop a conceptual framework for analysing contexts where policies fail after they succeeded elsewhere, particularly failure in the process of implementation.

Three sets of concepts were applicable for understanding the decision that the Indonesian government made to adopt the HWI policy and for explaining the unintended outcomes of it when the policy was implemented. The first is the concept of policy convergence (e.g., Kerr 1983) and diffusion (Rogers 2003 [1995]) derived from the globalisation literature. These concepts explain why a developing country such as Indonesia was eager to follow the path of more developed countries of having institutional arrangements within its tax administration that required established as well as sophisticated regulatory infrastructures. The idea of states striving and competing to be modern offered by the concept of a race to the top was useful in describing this situation. A HWI initiative within a tax administration represented best practice in managing the tax compliance of the ‘most challenging’ segment of the taxpaying community. Having such a HWI unit in the structure of its tax authority, so that Indonesia was regarded as having a modern tax administration, was an important motivational lever for policy adoption (as described in the convergence and diffusion literature).

The central argument provided by convergence and diffusion concepts is that certain options gain ascendancy as attractive solutions to solve similar problems faced by states because of the existence of a set of global pressures and structural constraints. These factors, combined with a rational economic analysis in which efficiency is the prime objective, underlie the decision to adopt policies that have proven effective elsewhere.

Examination of the adoption of the HWI initiative in Indonesia demonstrated that efficiency and rationality were not the only contributing factors to its adoption. The policy transfer framework (Dolowitz & Marsh 1996; 2000) proved a powerful analytical tool, enabling the raising of questions as to why and how a policy is transferred from one jurisdiction to the other. By posing these questions, the policy transfer framework could reveal the complex set of interactions that occurred in a particular policy transfer case. This framework also offered an explanation for understanding why a policy transfer led to failure by introducing the notions of uninformed, incomplete, and insufficient transfer. These notions, however, are too broad and cannot be used to understand processes that may lead to failure at the organisational level such as the DGT that is responsible to implement the policy.

Explaining the success or otherwise of policy transfer can be done from the perspective that different sources of pressures exist: international, national and organisational. While the focus of this thesis is the organisational level, the role of global 'invisible forces' (Rose 2002, p. 9) in affecting decision-making processes could not be discounted as an influence on the decision to adopt a HWI policy.

Power and social influence from the international, national, and organisational levels were at play in the adoption of the HWI initiative in Indonesia. At the international

level, an epistemic community of tax experts advocated for the HWI policy. The OECD's FTA, the IMF's FAD, and the World Bank were examples of global powerful actors that introduced new ideas in tax policies globally, including to Indonesia.

At the national level, Indonesia's political actors were also at play in decisions to adopt the HWI initiative. Such actors, in their effort to advance their political agenda, exerted pressures that resulted in the decision to transplant the policy.

At the organisational level, bureaucrats played an important role in determining the direction of the HWI policy once it was transferred and adopted. The meaning these actors gave to policy and relationships they built with internal and external stakeholders determined the destiny of the implementation of the policy in its new context.

The concepts of policy convergence, diffusion and transfer introduced the idea that a policy travels from one place to the other for particular reasons. But why, once the policy was adopted and implemented in a different context, did it fail to meet expected outcomes? At the very least, it did not work as recommended by experts from the tax policy epistemic community.

The second set of concepts that proved useful in explaining what had happened in the implementation phase of the HWI initiative in Indonesia was the principles, mechanisms and actors framework (Braithwaite & Drahos 2000). These concepts helped understand why actors weigh certain principles over others and how they sought to fight for the principles they assigned. In their pursuit of the principles they gave greatest weight, actors use mechanisms that they believe could accommodate their interests. When the principles of actors conflict with the principles of others,



contestation between principles within the organisation occurs. When conflict occurs, how do actors maintain their interests so that they can still achieve their goals? The third concept that assisted in answering this question was webs of influence (Braithwaite & Drahos 2000).

The webs of influence model assigned an important role to powerful actors at the organisational level such as the DGT (i.e., officials in strategic positions) in explaining the behaviour and actions of actors in operational positions. The webs of influence included webs of dialogue and webs of control. Actors who believed that a complex policy such as the HWI initiative required a long-term process and shared commitment among involved stakeholders used webs of dialogue, through which actors at different levels within the DGT and outside stakeholders had opportunities to share ideas for the benefit of the policy. In contrast, actors whose orientation through the policy was short-term preferred to utilise webs of control. Using webs of control meant powerful actors could gain compliance from other actors and stakeholders, although the compliance could be more superficial. The negative consequence of using webs of control was that it damaged shared commitment developed in the previous period of the implementation of HWI unit. Damaged shared commitment and understanding of the policy contributed to the failure of the HWI policy implementation in Indonesia.

Combining the analysis of policy adoption and policy implementation was a theoretical development that this thesis contributed to the literature.

### **8.3 Summary of the findings**

The major findings address two themes that flow the two theoretical frameworks. The first theme relates to policy transfer and the explanations for failure of the HWI

initiative within a policy transfer theoretical perspective. The second theme relates to failure in implementation perspective. These failures come to light using a principles-mechanisms-actors and webs of influence framework.

### **8.3.1 Obstacles revealed through policy transfer literature**

The policy transfer framework in particular gave rise to hypotheses 1(a) and 1(b) which signalled the ‘do something’ response and the coercive and voluntary elements in the transfer of the policy. These guiding hypotheses led to a realisation of the importance of learning in the HWI policy context. Insufficient learning was an important issue in unsuccessful policy transfer.

The adoption of the HWI initiative in Indonesia shows policy learning from the international community to some extent, but also shows signs of superficial learning, even perhaps emulation. This conclusion was derived from the fact that a HWI unit held great symbolic value for the higher echelons of DGT, the MoF and the government. They were eager to show that meaningful bureaucratic reforms were occurring in Indonesia’s public services in general and the tax administration in particular. Importantly, the learning that had taken place led Indonesian actors to focus on ‘operationalising the machine’, not on understanding the ‘structure of the machine’. This meant that actors gave more attention to the delivery of outputs than to understanding the foundational principles that would make the policy work well. The superficial nature of the learning was demonstrated empirically by two findings, one from the adoption phase and one from implementation.

The political imperative to ‘do something’ (Sharman 2010) at the national level that would bring positive recognition of Indonesia having a modern tax administration was

accompanied by elements of domestic coercion and haste. Learning was enhanced by active enlisting of advice from the epistemic community of tax experts internationally, but there was no institutional mechanism for consolidation.

Transfer of the HWI initiative in Indonesia involved little reflection. The second piece of evidence of superficial learning was the rapidity with which the HWI unit was attenuated before being given a chance to succeed.

Further insight into why the HWI unit failed to meet expectations was foreshadowed by guiding hypothesis 2 which highlighted structural compatibility between the transferring and adopting country for successful outcomes.

The organisational and legislative structures and procedures in which the HWI unit was embedded were largely inappropriate for the kind of change that was hoped for in tax compliance. If the structural gap between the transferring and adopting country is large, such that the supporting elements in the transferring country are not present in the adopting country, a critical analysis is required to identify how the policy might operate in the new context. This did not occur in Indonesia with respect to the HWI policy.

The organisational and legislative structures and procedures underpinning the work of the HWI taskforce in Australia included Australia's tax laws and code, the Australian taxpaying culture, the ATO's regulatory frameworks, and principles and mechanisms that shaped the way in which the ATO in general, and the HWI taskforce in particular, practised their craft. Failure to recognise that the HWI initiative in Australia was supported by these elements, and that there was a higher level of coordination in the ATO's functioning than in the DGT's, contributed to unsuccessful transfer.

Guiding hypothesis 2 threw light on another characteristic of Indonesia's tax system that made change difficult. Geographically dispersed collection offices had their own lists of registered taxpayers and their own compulsory revenue targets. There was no advantage for them in cooperating with a new HWI unit at the same level of authority as their own. Managing the tax compliance of HWIs requires understanding of the tax affairs of the HWIs as individuals, and their related entities. HWI-related entities were administered in TSOs around Indonesia; acquiring data about HWI-related entities demanded a system that would support the unit with rich information and well-defined and understood information-sharing procedures. In Indonesia, the development of a data-sharing culture was the top priority of the HWI unit but it clashed with the well-entrenched practices of DGT. Structural flexibility did not exist, and geography did not make it easy to change.

Connected with the physical constraints of geography and data reporting was the taxpaying culture of Indonesia. The Indonesian tax system is an institution that the Indonesian people, including HWIs, largely distrust. Therefore, changing the way the tax system engaged with HWIs was not readily embraced as a credible means of improving the tax system. The tradition of taxpaying in Indonesia is of imposing a low tax burden and tolerating high non-compliance, within a culture dominated by disengagement with the tax system. The low tax burden and high non-compliance is reflected in Indonesia's low tax-to-GDP ratio compared to similar countries in the region. Introducing a new HWI unit into such a system required broad-based efforts to change the public perception of the whole system and engagement with taxpaying if it were to be successful.

Hypotheses 1 and 2, stemming from the policy transfer literature, were useful in shedding light on the challenges of adoption of an HWI program. Indonesia's program was based on Australia's. Indonesia did not have Australia's legal or organisational infrastructure in which to embed their HWI unit. Moreover, Indonesia's geography, revenue target operations and dispersed and independent data collection system (within local TSOs) was not ready to accommodate an HWI unit whose operations needed to be integrated with TSOs across the country. Finally, unlike Australia, Indonesia did not have a trusted tax authority and compliant taxpaying culture.

Transferring a policy from another country requires thoughtful consideration of the policy in question and its related aspects in its transferring country, as well as the policy environment in which it is to be implemented. This is particularly important when the policy was transferred from a country that differs from the adopting country in many aspects. Transfer of the HWI initiative from Australia to Indonesia represented this situation.

### **8.3.2 Obstacles revealed through a principles-mechanisms-powerful actors framework**

The focus of this thesis was on the implementation stage of a transferred policy, in particular on the conditions at the organisational level which were crucial in determining the success or otherwise of the policy. Hypotheses 3(a) and 3(b) introduced the idea of policy transfer being implemented through powerful actors articulating key principles and supporting mechanisms that led to the realisation of those principles.

Hypotheses 4(a) and 4(b) guided the research to look for how ideas about the HWI unit and its requirements were shared in the organisation. The research found evidence of

both webs of control and webs of dialogue, and as foreshadowed in hypothesis 4(a), webs of control in time dominated webs of dialogue so that there was less sharing of information and knowledge horizontally and vertically. Without webs of dialogue and with the domination of webs of control, traditional tax collection practices reasserted themselves. The HWI unit disappeared in the same confusion as it began. These hypotheses provided useful insights into how the HWI unit fared at implementation. My research produced a deeper understanding of obstacles to implementation.

First, rigidity in the structure of the Indonesian tax administration system restricted the possibilities for new tax policies. Rigidity meant that when the HWI unit was introduced, most of DGT carried on with a business as usual approach. Tax administration practices were not adjusted to support ‘regulatory innovation’ (Black, Lodge & Thatcher, 2005) and experimentation (Dorf & Sabel 1998). One specific example of this rigidity was in the mechanisms used to set workloads and evaluating performance.

Second, revenue targets and their achievement placed constraints on change. This was the overarching principle governing the Indonesian tax system, and was well entrenched in the mindset of tax officials. Over 30 years ago Lerche (1980, p. 50) called Indonesia’s tax system a ‘target system’, that is, a tax system in which the ultimate goal is the achievement of revenue targets determined through a top-down process. Lerche’s description has endured in reality (Brondolo et al. 2008). In Indonesia’s tax administration, target achievement serves as a measure for reward as well as punishment. Rewards and punishments control priorities and activities of individual tax officials.

A third obstacle that became apparent as implementation was realised was time. Having time to explain principles and develop mechanisms was a crucial factor for the implementation of a 'foreign' policy such as the HWI initiative. New foreign policies need time to be fully understood and bedded down. Limited time was allocated for implementing the HWI policy. This inevitably meant that the process of implementing the HWI initiative lacked some important supporting elements. The predicted decline in tax revenue in 2008 due to the GFC (i.e., fiscal crisis) and a looming presidential election in July 2009 (i.e., political imperative) put pressure on the DGT to implement the HWI initiative quickly. The limited time available for implementation of the policy gave little room for reflection on the problems that might be encountered in transferring the policy from elsewhere. Limited time given to realise the HWI unit's output in terms of revenue collection made powerful actors chose to use webs of control rather than webs of dialogue to disseminate policy ideas, particularly during the second period of HWI unit implementation. Moreover, the limited time span from when the policy was set up until being implemented meant the HWI policy was run without a proper written plan.

The fourth obstacle, signalled in hypothesis 4(b), was the lack of the horizontal and vertical communication needed for change to occur and to ensure the whole organisation understood the role and expectations of the HWI unit and supported its goals. Understanding of the policy means policy ideas, principles and goals are shared evenly across actors involved in and affected by the policy. The way in which policy ideas are communicated by actors in superior positions is important in determining how they are understood and accepted by those in subordinate positions (Job & Honaker 2003). Powerful actors in DGT during the second period of HWI unit operation failed to

use channels of communication with internal and external stakeholders when the policy direction changed. The HWI unit staff responded to demands from headquarters, but DGT as a whole did not have a coherent framework communicated throughout the organisation about how the ambition of increasing tax collections from individual taxpayers was going to be realised. Consequently, the same policy was accepted and understood differently.

The fifth obstacle was failure to plan for continuing dialogue so that problems of implementation could be talked through and resolved as they emerged. Dialogue amongst actors at different levels across an organisation increases levels of participation and commitment. Dialogic webs used in communicating policy ideas provide various actors with an opportunity to share a coherent philosophy to learn, understand, adapt, and trial ideas. Dialogic webs mean that all actors participate in the process voluntarily rather than coercively (see Job and Honaker (2003) for a description of the Australian context when the ATO compliance model was introduced). DGT's powerful actors' tendencies to use webs of control during the second period of implementation of the HWI policy silenced actors in subordinate positions.

Lastly, there was a need to acknowledge that when actors felt that they could not participate in the decision-making processes of implementing change, the risk of resistance to that change increases. Resistance was not a hypothesised outcome of this research. Poor communication was anticipated to result in poor support and poor learning. Resistance became apparent as a result of the interviews. Resistance in response to the HWI unit's introduction meant that although tax officers were accustomed to following directions from DGT headquarters, they did not follow the directive about the new HWI policy as commanded. TSOs would not pass over files to



assist the HWI unit develop its integrated individual–enterprise database. When the second period of implementation set in, the HWI unit followed directions to collect revenue. But even here, there was passive resistance. Their hearts were not in it and they communicated a sense of meaninglessness and confusion over their tasks.

In short, obstacles for implementation of the HWI policy in Indonesia can be categorised as problems of institutional capital, human capital, and social capital. The institutional factors included a culture of tax non-compliance in Indonesia, DGT's revenue target culture (with a history of coercive and corrupt practices that has undermined cooperation with the tax authority), and a geographically dispersed tax authority organised around the achievement of designated revenue targets.

The human capital factors included insufficient training of auditing staff and those developing policy. Part of the problem was that learning was superficial because training was not sufficiently in-depth, and there was insufficient time to acquire knowledge and absorb and share the learning that had taken place. Policy staff did not give deep and broad consideration to the contextual factors that come into play at the implementation stage and make a policy work.

The social capital barriers stemmed from the rigid hierarchy that defines DGT. Communication within the organisation was poor. Webs of control in which directives are given through a command-and-control style from the senior levels of the organisation to subordinates has traditionally characterised DGT. Webs of dialogue were set up in the first period of the HWI unit implementation to facilitate information exchange from bottom to top and top to bottom. These webs of dialogue did not endure. As webs of control dominated webs of dialogue, the DGT executive did not learn about

the frontline officials' successes and failures. The social distance between the top and bottom of the organisation, and poor communication with collapse of the webs of dialogue, meant low trust and high resistance to directives received from above.

#### **8.4 Resistance: an overarching theme of the findings**

The overarching and somewhat unexpected theme that explains the failure of implementation of the HWI initiative in Indonesia is the resistance to follow directives exhibited by actors on the ground. The human dimension is one of the factors most critical to successful change implementation (Georgalis et al. 2014, p. 3). Employees play an important role in change initiatives (Fugate et al. 2012). They not only act as change implementers, but also and more importantly they are change recipients. Therefore, according to Fugate, the success or otherwise of the initiative is to a large degree determined by their commitment.

Introducing the HWI initiative in the Indonesian tax administration heralded significant change in tax administration management. The initiative changed long-held practices in relation to how the tax authority should deal with taxpayers in general and affluent taxpayers in particular. As Job and Honaker's (2003) study of the introduction of a responsive regulatory model in the ATO (discussed in Chapter 4) showed, resistance may come from actors who are afraid to try new ideas or who prefer to maintain the status quo. Often, resistance reflects an individual's objection on how authority is *using* its power, rather than objection to an authority *having* power (Braithwaite 2009, p. 254). This was most likely to be the case in DGT where power distance was the norm and staff were accustomed to obeying their superiors. Obedience, nevertheless, did not preclude feelings of threat.

The HWI initiative adopted from Australia introduced new approaches to dealing with the taxpayer community – regulatory approaches never previously attempted in the Indonesian tax administration. In these regulatory approaches, in which both service and compliance activities existed side by side, the question was not whether to punish or to persuade, but rather when to punish and when to persuade (Ayres & Braithwaite 1992, p. 21). The DGT leadership had not reconciled their thinking to how these concepts could co-exist, possibly due to their immersion in a long-running culture of coercive approaches. Compliance activities (represented by auditing, for instance) were undertaken not as a regulatory strategy to send a message to non-compliant taxpayers and the public in general that what they had done (e.g., tax avoidance or evasion) was unacceptable and to return them to a compliant state, but rather to collect more revenue. Changing this long-held culture was challenging, particularly among those who believed that the coercive approach was an effective way to meet revenue targets. And when tax officials were sufficiently coercive, there is little question that taxpayers paid whatever was owing.

The resistance of many DGT actors to the HWI unit and the changes it brought resulted in ‘punitive’ actions toward HWI unit staff. Webs of control replaced the newly introduced webs of dialogue. Coercion undermined the commitment of staff on the ground to pursuing the HWI unit’s agenda. Coercion, took the form of deployment (actual or threatened) to an undesirable place when revenue targets were not met. Headquarters’ dismissal of the new practices invented by HWI unit staff for developing a taxpayer’s database, without considering the importance of integrated data to the HWI unit, was another example of how the threat of coercion undermined proper HWI policy implementation. Resistance was not discussed openly: it was expressed through

removing the mechanisms that the HWI unit staff needed to continue their innovative agenda. In response, staff at the HWI unit were demoralised. They too felt resistance. But they followed orders from their superiors. Their resistance took the form of disapproval in silence. There was a passive resistance that could not be safely voiced.

## **8.5 Limitations and future research**

The limitations of this study exist at the level of study scope and methodological rigour.

The scope of the study was restricted to adoption and implementation of the HWI policy within the ranks of the DGT. A focus on principles, mechanisms and actors at this level was considered innovative in this thesis. Too often the assumption is made that a policy adopted at the top of an organisation will be implemented automatically. This thesis considered the possibility that efforts in implementation were worthy of research in their own right. When this research was planned, the political forces at work that would undo the decision to adopt an HWI policy and undermine implementation were not obvious. The political process forces were not visible or openly discussed in interviews. But at least some of those interviewed thought that a political story existed. This thesis did not uncover this story. Interviews with more senior actors in the DGT and the government might have informed this study about the magnitude of political pressure on the HWI unit, but I was not successful in obtaining these interviews. For example, of ten invitations I sent to members of Indonesia's House of Representatives (*Dewan Perwakilan Rakyat, DPR*) only one responded and participated in the interview. I interviewed seven senior tax officials at the DGT, but it was not enough to reveal political narratives about the HWI policy.

The original intention of conducting a comparative study between Indonesia and Australia was thwarted by some methodological problems. The access I had to tax officials and stakeholders was not comparable in the two countries. I managed to interview 42 respondents in Indonesia and only 14 respondents in Australia. For this reason, the Australian case was used as a benchmark of best practice in implementation. A wealth of information on the HWI Taskforce enabled me to extract a set of propositions about how an HWI initiative should proceed.

A third issue affecting methodological rigour was familiarity with interviews, both culturally and institutionally. With Indonesian respondents from DGT officials, culturally discussing policy that had been defined top-down with an outsider such as myself was uncommon.<sup>97</sup> Informants, especially those from middle-down levels, hesitated to disclose their thoughts, feelings and opinions on the way in which senior officials treated them and how the HWI unit was run. Instead they used metaphors to describe their opinions. With Australian respondents, my status as an outsider as well as a foreigner to the Australian taxpaying community institutionally hindered me from attracting more participants to discuss the HWI policy in Australia (with the exception of the tax officials group).

Finally, the single case study in this research limited the power of generalisation of the findings. Future research should attempt to involve multiple cases in multiple countries. Comparing different new initiatives in one tax authority would help disentangle sources of resistance: are they fuelled by cultural, whole of organisation issues or are they more

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<sup>97</sup> In Chapter 3 I discussed my status as 'insider-outsider' during the course of this study for the Indonesia context.

a function of poorly planned implementation strategies? Alternatively, a study of established HWI units across different countries would shed light on the elements and approaches that enhanced prospects of success in building positive relationships with HWIs and responsive approaches to collecting their taxes.

## **8.6 Implications of the study for the field of policy transfer and implementation**

This research is novel in that it combines analysis of policy transfer with analysis of policy implementation using the concepts of principles, mechanisms, actors and webs of influence. Few previous researchers (e.g., Christensen 2013; Sharman 2010) have combined policy transfer analysis (macro) with analysis of policy implementation (micro). Whilst macro forces such as globalisation and policy convergence are acknowledged as contributing factors for transferring policy from elsewhere, my study also found that national and organisational factors influenced the process of transfer and shaped outcomes of implementation. This research demonstrates that it is unwise to underestimate the ability of local powerful actors to facilitate or impede the success of implementing a transferred policy.

Adding policy implementation analysis into a policy transfer case provides a deeper understanding into why a best practice policy from the global sphere does not fit certain contexts such as that of the HWI policy in an Indonesia context. A micro level of analysis at the organisational level offered in this thesis has potential to be adopted in other policy transfer studies, because there will always be organisation(s) which are responsible to implement a policy once it is transferred from elsewhere. The success or otherwise of the implementation to some degree is determined by factors existing at the organisational level.

This study is a reminder for national policymakers and global members of the epistemic community that a policy transferred from one country to another may take a form that even the actors that initiated the transfer process had not imagined. Although this issue has been raised by various authors (e.g., Bauer (2013) in economic policy, Biesma et al. (2009) in health policy, and Ladi (2004) in environmental policy), the findings presented in this thesis reiterate the importance of studying the broader context of the policy under consideration (i.e., principles underlying the policy, cultural background, regulatory infrastructures, and institutional arrangements), not only the technical aspects of the policy.

## **8.7 Current developments in Indonesian politics and HWI initiative**

In the middle of writing this thesis (April 2012), I received an email from a colleague in Indonesia informing me about a surprising change in the HWI unit. A Finance Minister decree stipulated changes to the HWI Tax Service Office<sup>98</sup> in both its name and function. The High Wealth Individual Tax Service Office (HWI TSO) was to be incorporated into the Large Taxpayers Tax Service Office IV (LTO IV), but importantly the unit's function was also changed substantially. The office's function was altered so that it would administer state-owned companies, especially those engaged in the service sector (e.g., banking, insurance, construction, transportation, etc.), as well as HWI taxpayers.

This change occurred in spite of internal and external recommendations (including from IMF advisors) to continue the HWI initiative as a unit dedicated solely to administering

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<sup>98</sup> The Minister of Finance who approved this change was not the same Minister who approved the establishment of the HWI unit in 2009.

individual taxpayers. Indeed, there was a recommendation to expand the unit model across other regional offices throughout Indonesia (General Secretary of Ministry of Finance 2010; IMF 2011c). Prospects of continuation and growth, however, were supplanted by the short-term revenue-generating policy orientation of the Indonesian tax system. This detracted focus from the HWI unit's long-term policy goal of improving the tax compliance of wealthy individuals. Although HWI taxpayers are still administered at this new TSO, their insignificant tax revenue contribution compared to that of state-owned companies will reduce the attention given to HWIs. Adding corporate taxpayers to the HWI unit's responsibilities will relieve some of the psychological pressures on HWI unit staff: The HWI unit will no longer be 'an ant among elephants' because of its small tax collection and no longer a 'source of ridicule' (see section 6.2, Chapter 6). However, the wisdom of the change from an institutional perspective may be questioned. Bird and Zolt (2003) warned that tax-related policy should not be altered on a temporary basis to meet short-term agendas. Nevertheless, the tax system's long-held orientation to revenue target achievement and political expectations expressed in some interviews of 'business as usual' surely contributed to the decision to discontinue the HWI unit as a regulatory unit dedicated solely to managing the tax compliance of Indonesia's very wealthy individual taxpayers.

In Chapter 5 I suggested that one of the reasons underlying the adoption of the HWI initiative in 2009 was to support an incumbent president who would run in the presidential election with a strong message of promoting bureaucratic reforms. The president's party won in a landslide, and SBY was re-elected for his last term. While a political perspective was not within the scope of this thesis, it is nevertheless important to note that some authors believe that the significant loss of votes for the Democratic



Party in 2009 was due to the failure of SBY's administration to reform Indonesia's bureaucracy (Nashrillah 2014) and the corruption allegations involving the Democratic Party's elites and legislators (Cochrane, 2013).

A recent national survey revealed that 85 per cent of respondents were dissatisfied with the performance of the SBY administration: 'How can an administration that came to office with 60 per cent of the popular vote have fallen this deep [sic]? This means that all they had was an image without actual results' ('SBY's term ends' 2013). In April 2014 Indonesia held a national legislative election. While the result has yet to be finalised, preliminary results suggest that SBY's party, the Democratic Party, won significantly fewer seats than in the previous election. In July 2014, a new president from another party was elected.<sup>99</sup>

These political developments align with my study's finding that the decision to adopt a policy transfer of the HWI initiative in Indonesia was primarily to satisfy a political imperative to provide an image of public service reform. This is not to denigrate the considerable efforts devoted to making it work. Advocates of reform who wait for an opportune moment to pursue change can be genuine in their commitment and pursuit of principles and mechanisms that will unseat old patterns of behaviour.

Discontinuity of the HWI tax service office's function as a unit dedicated solely to the administration of taxes for wealthy taxpayers has been disappointing. HWI initiatives in Australia and other countries have been successful in improving the tax compliance of wealthy taxpayers and their related entities (OECD 2013b). Importantly, if managed

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<sup>99</sup> The decision of the final national legislative election has to await the Constitutional Court's judgement due to the lawsuit filed by several parties challenging the legality of the results.

properly, a HWI initiative can also improve public confidence in the integrity of the tax system (Michael Cranston, ATO's deputy commissioner, cited in Vedelago (2014)). The lessons to be learnt from the HWI unit in Indonesia are many. They can be summarised by concluding that if a policy is transferred from elsewhere, recognising and compensating for institutional differences requires detailed study and planning, recruiting and training for human capital needs to be amply resourced, and leadership to use webs of influence (both webs of control and webs of dialogue) to harness social capital to carry the policy forward into full implementation. While these steps are likely to be important in any policy transfer situation, they are particularly vital when policy is transferred from developed countries to developing ones.

# Appendices

# Appendix—A: Method for Selecting Literature on Taxation Policy

## Developing the search criteria

All references included in the review had at least one of the core terms policy, transfer and taxation in their abstracts. I searched using other relevant keywords in combination with those core terms. Table 1 shows the combinations of keywords and terms used in the literature search. I employed Boolean search terms (‘AND’, ‘OR’, ‘NOT’) to make the process more efficient.

**Table 1 Search terms used in selecting literature**

<b>Policy</b>	<b>Transfer</b>	<b>Taxation</b>
Law(s)	Diffusion	Taxes OR Tax
Regulation(s)	Band-wagoning	Goods and Sales
Institution(s)	Lesson drawing	Value Added Tax OR VAT
Idea(s)	Learning	Fiscal
Program(s)	Convergence	State revenue
Ideological Concepts	Isomorphism Systematically pinching idea	
Instrument(s) Regulatory arrangement(s) Institutional arrangement(s) Administrative arrangement(s)		

Other criteria that I set for this selection process were publication, time period and language. That is, the selected works must have been published in peer-reviewed journal articles, between 1991 and 2012 inclusive, and written in English.

### **Identifying data sources**

The review was based mainly on electronic searches with searching of print material only when needed. Electronic data sources included internet search engines, notably Google and Google Scholar, and general academic databases, such as the Social Science Citation Index and International Bibliography of the Social Sciences.

### **Inclusion and exclusion criteria**

In order to decide which retrieved materials would be included in further analysis, I developed a set of inclusion/exclusion criteria. Studies of policy transfer included in the review had to be in the area of taxation (local or national tax, direct or indirect tax, or tax administration in general) and demonstrate a process of policy transfer of tax policy from one jurisdiction to another – within a nation or between nations.

# Appendix—B: Summary of Studies in the Diffusion and Policy Transfer Literature on Taxation

Source	Regions/ Countries	Period	Research focus	Research findings
Berry and Berry (1992)	48 states in the U.S	1916-1937	Assessing the factors that prompted states to adopt taxes (the gasoline tax and the individual income tax)	Using event history analysis and a pooled cross-sectional time-series technique, this study tested five factors that explained state tax innovation which include: (1) economic development; (2) party control explanations; (3) the presence of an election; (4) the existence of a fiscal crisis; and (5) the presence of neighbouring states that have previously adopted a similar tax. It is suggested that while there is little support for the first two factors playing a role in the decision to adopt tax in a given state, the other three factors increased the probability of the adoption of similar taxes. All these three factors created opportunity for politicians to shield themselves from the political costs of supporting a tax increase.
Radaelli (2000)	European Union	1990s	Examining public policy transfer in the EU, in relation to the single currency, tax policy and media ownership through the concept of isomorphism	Policy transfer within the EU involves the EU Commission and member states. This paper asks how policies that have the support of the EU are transferred to member states. The author uses the concept of isomorphism to argue that the EU catalyses the isomorphic process through working or watching for the adoption of the policy in one member state. Once one member state takes action to adopt a policy, others follow. Mechanisms involve coercion, mimetism (copying) and normative influences. Central to how the process works is the establishment of technocratic legitimacy for the European Commission. Technocratic legitimacy in relation to the single currency involved both

Source	Regions/ Countries	Period	Research focus	Research findings
				<p>coercion and mimetism. Coercion was reflected in the strong power of the Deutschmark in the European monetary system. Germany was perceived to have the most successful national model of monetary policy, and other countries followed Germany's lead. In the taxation field, however, technocratic legitimacy remains poor. It is because the very idea of a national tax system that is considered optimal (or most desirable) for tax harmonization does not exist. The mechanism of normative pressures is more prevalent in the taxation context, where an epistemic community has been very active in calling for some forms of tax reform (pp.25, 37-38). In the field of media ownership regulation, the Commission used a two-step process of developing a model, waiting for that model to be adopted in a member state, and then encouraging the transfer of that model to other member states.</p>
Radaelli (2003)	European Union	1990s	Examining the code of conduct against harmful tax competition as a new governance architecture in tax policy and comparing it with the open method of coordination (OMC)	<p>The study sought to answer three questions: (1) to what extent does the code of conduct on business taxation follow the template of the OMC? (2) Is a 'new governance architecture' – based on learning processes and the inclusion of social actors – emerging in EU tax policy? (3) What are the results achieved by the code? The OMC is a means of spreading best practice and achieving convergence towards the EU goals (p.513). The idea is to use the EU as a transfer platform rather than as a law-making system. It is argued that the tax code against harmful tax competition is consistent with the basic features of the OMC. That is, the code of conduct seeks "compliance" based on guidelines, peer review, best practice, benchmarking, learning and diffusion of shared beliefs among policy-makers.</p>

Source	Regions/ Countries	Period	Research focus	Research findings
Ashworth <i>et al.</i> (2006)	308 Flemish municipalities in Flanders, Belgium	1991-1999	Analysing the elements that affect the decision to introduce an environment tax (green tax)	The purpose of this paper was to see if regional diffusion had an influence after taking account of internal factors known to affect the adoption of green policy and changes in tax policy more generally. The authors concluded that political factors are highly significant in the introduction of a green tax: The presence of an election discourages the adoption of the green tax, and left oriented governments are more likely to introduce a green tax. Evidence of regional diffusion was also found. Neighbour effects were significant: The adoption of the tax by a given municipality was more likely when neighbours had adopted a green tax. Also important for green tax adoption was having municipalities that were ideologically similar adopt the tax.



Source	Regions/ Countries	Period	Research focus	Research findings
Eccleston (2006)	OECD and 115 other countries	1990-2000	Exploring the specific processes that led to the spread of VATs across countries	Tax reform generally and consumption tax proposals in particular achieve political prominence when policy elites agree on the goals of tax reform and there is wider political acceptance of problems with the tax policy status quo. However, it is important to recognise that policy problems and associated solutions are socially constructed and depend on how actors interpret their context. The role of actors and policy entrepreneurs in linking policy proposals to the political problems confronting government leaders is then important. Despite an emerging elite consensus on the merits of VATs, there has been considerable variation in terms of when VATs were introduced, the rates at which they have been levied, and the manner in which they have been administered. In terms of the policy transfer literature this amounts to a case of policy emulation, in which policy ideas, rather than specific policy settings, have been transferred.
Swank (2006)	16 developed countries	1981-1998	Examining the spread of neoliberal tax policy in developed democracies	The tax treatment of corporate and capital income has changed dramatically across the capitalist democracies. The basic goals of tax policy have also shifted from redistribution and interventionism toward efficiency. National policy-makers have responded to common international and domestic pressures to be competitive. Yet, the shift to a neoliberal tax structure was not solely a response by national policy-makers to these common forces. It is suggested that US tax reform in 1986 which brought a drop in corporate tax rates shaped tax policy changes in other nations. In the long term, all nations have moved toward the U.S. neoliberal tax structure. In the short-term, responsiveness to U.S

Source	Regions/ Countries	Period	Research focus	Research findings
				tax reforms was greater where uncoordinated market institutions were dominant. The research suggests that pressures to compete for mobile assets anchor the process of diffusion of neoliberal tax policy. However, economic and political costs may slow diffusion of neoliberal tax policy. There was little evidence to suggest that the diffusion was driven by systematic policy learning or social emulation.
Stewart (2007)	Ghana	1980s-1990s	Examining transfer of tax ideas to developing countries since 1980s in the context of structural adjustment by using Ghana as an example, with particular attention on VAT reform	Ghana's VAT reform of 1995 was enacted by elected officials with the engagement of external and domestic actors. It was led by bureaucratic and political actors in need of increased tax revenues. The lack attention paid to domestic political issues and little involvement of public and parliament in policy consultation led to the policy failure. Learning from this experience, the 1998 VAT reform involved a more engaging political consultation and compromise, including "educating" members of parliament about the VAT.
van Stolk and Wegrich (2008)	6 developed countries	2005-2006	Analysing the driving forces for the choice of particular performance indicators for administrations overseeing tax and social security in six countries (Australia, Canada, Netherland, Sweden, the UK and the US). The study compares global influences and domestic constraints resulting from legislation and systems of administration	In both taxation and social security administration, reform ideas at the abstract level take place across governments through existing international networks and shared values on public service delivery (e.g. New Public Management), but how those ideas are turned into actionable goals within a country is far more likely to be determined by domestic consideration. With regard to tax administration, a world-wide focus on the relationship with the client (i.e. taxpayers) is noted as having impacted on the internal organisation of tax agencies. Most notably, a client focus has meant that tax administrations have restructured around the activities rather than the types of taxes that

Source	Regions/ Countries	Period	Research focus	Research findings
				are administered. In keeping with an interest in service quality is an over-abundance of performance indicators in the service category. This is of note because tax administrations have been rather resistant to adopting these ideas in the past due to their traditional hierarchical “compliance culture” concerned with upholding an image of uniform enforcement of rules. Yet, these performance indicators differ across countries. While “service quality” is shared across countries as a strategy to increase “voluntary compliance”, the driving force in the development of related PIs has been more domestically based, for example by governance arrangements primarily, and only via domestic debate is there likely to be adoption of internationally recognized benchmarking indicators.
Baturo and Gray (2009)	15 Eastern Europe countries	1994-2007	Examining factors that explain the wave of adoption of the flat tax in Eastern Europe	It was found that the presence of other market-minded reforms do not predict adoption of the flat tax. Instead, rational learning, where economically right-wing governments evaluated the success of the reform (as measured by their ability to attract foreign investment) in the medium term, plays the largest role. In other words the flat tax has taken off in Eastern Europe not as a result of blind imitation, but by policy makers rationally updating their beliefs about the tax’s appropriateness for their own country after observing its success in neighbouring countries.
Ellis (2009)	Slovakia, the Czech Republic	2004-2008	Examining the reason for the adoption of a flat tax in Slovakia and the Czech Republic and whether such adoption is a product of policy diffusion	Slovakia and the Czech Republic were latecomers to adopting a flat tax. Unlike Latvia and Lithuania, where changes in tax policy were relatively easy, changing the tax scheme in Slovakia and the Czech Republic have been much more difficult. These countries owe the adoption in large part to the

Source	Regions/ Countries	Period	Research focus	Research findings
				commitment of right-wing politicians, political parties and think tanks. These actors helped to explain why a flat tax was to be adopted in both countries. The idea of the flat tax addressed some important issues such as preventing tax evasion, attracting foreign direct investment, and simplifying tax collection. Commitment to and knowledge of the flat tax, however, did not guarantee adoption. The political environment had a pivotal role to play for the success of adoption. The adoption of flat tax policy required centre-right governments. This condition explained why the adoption of a flat tax policy in Eastern Europe is considered "late adoption".
Gilardi and Wasserfallen (2009)	26 cantons in Switzerland	1990-2007	Investigating the extent to which interdependent tax decision making follows rational competitive pressures or other dynamics	Spatial interdependence is examined as an explanation of personal income tax rates in Swiss cantons. In addition to measuring neighbouring cantons, the number of commuters is introduced as a measure of spatial interdependence, the argument being that a canton does not want to have a non-competitive tax rate and a non-competitive tax rate will be reflected in the size of its commuter population. The study found that the tax rates for higher income earners were similar among neighbouring cantons and among cantons where many commuters lived, although neighbouring cantons seemed the stronger predictor of tax rate. The authors concluded that the fact that policy-makers reacted more consistently to the decision of their neighbours, than the decision of cantons from which competition pressures are most evident (high number of commuters), may indicate that interdependent tax policy-making is less rational than expected (pp. 21-22). Also influencing tax rates were

Source	Regions/ Countries	Period	Research focus	Research findings
				social networks comprising a regional conference of finance ministers which built cooperation and downplayed competition among cantons. The authors also suggest that tax reforms in neighbouring cantons may have been a way of legitimizing politically controversial tax cuts to the wealthy rather than a driving force for change.
Kim <i>et al.</i> (2009)	66 Florida counties in the U.S.	1988-1991 and 1988-2003	Exploring the phenomenon of the adoption of infrastructure surtax (i.e. Local Government Infrastructure Tax-LGIS) by examining factors that influence subnational government's decision to adopt the policy	It is suggested that factors such as the neighbouring counties previously adopting Local Government Infrastructure Tax (LGIS), the population density, and a millage rate for the property tax are the major factors explaining the probability of early adoption. While the first two factors influence in a positive direction, the third factor influence the probability of adoption in a contradictory direction. The study found that political ideology (recalled from presidential election data) did not play a role in policy adoption at subnational level. The authors argued that political consideration at the federal level was not significantly important in decision at the county level. The study concluded that the pattern of LGIS diffusion reflected more the competition model of diffusion rather than social learning. The explanation for this is because counties are more likely to act more competitively in seeking to secure tax bases due to lack of a strong tax base such as income compared to the federal or state government.
Cao (2010)	133 OECD and non-OECD countries	1998-2006	Studying policy changes in capital taxation by focusing on policy interdependence induced by network dynamics at the international level	This study offered two hypotheses: first, similarity in network positions induces strategic competitive races in corporate taxation and peer competitive pressure. Second, the closer the two countries are in networks, the more "similar" they are in terms of domestic economic policies. This proximity facilitates policy learning and emulation and therefore policy diffusion. It is concluded that policy diffusion in corporate taxation was caused by the

Source	Regions/ Countries	Period	Research focus	Research findings
				competition mechanism that was induced by network position similarity in the network of portfolio investment and the network of exports. It is also suggested that socialisation mechanisms (policy learning and emulation) that were induced by network position proximity in the inter-governmental organisation (IGO) networks also drove policy changes. While in policy learning the consequences of similar policies in other jurisdiction influence the adoption of the policy in question in other jurisdiction, in policy emulation, on the other hand, the objective consequences of the policies is less considered. Rather, the symbolic and socially constructed characteristics of the policies are pivotal. The evidence is stronger in the IGO networks that facilitate policy learning than those that facilitate emulation. The study also found that contiguity in geography causes policy interdependency.
Kemmerling (2010)	9 European countries and 9 OECD member countries	Unspecified	Reviewing tax policy convergence for four major fields of taxation (i.e. VAT, corporate income tax, personal income tax, and excises) after Europeanization	This paper suggests that the competition and co-ordination explanations alone are not sufficient to explain the role of Europeanisation of national tax systems. In direct taxation, the mechanism of competition is enhanced by forms of supranational imposition, whereas in indirect taxation the mechanism of co-ordination is enhanced by policy learning. These differences can be summarised in two different “models”. In the first model relating to indirect taxation, governments seek new forms of public revenues to compensate revenue losses or to cope with increasing demands for public goods. The role that the EU played in this model was as a catalyst for spreading ideas and might also have

Source	Regions/ Countries	Period	Research focus	Research findings
				been a source of legitimation for national governments fearing the electoral consequences of raising indirect taxation. In the second model relating to direct taxation, rising tax rates and revenues would face less electoral costs since they disproportionately affect smaller segments of the electorate: large companies and rich voters. In this context, the EU cannot be used as a legitimation device or as a 'learning ground'. The expansion of Europeanisation after the introduction of the single market has sharpened conflict of interests among member states.
Martin (2010)	States in the US	1971-2006	Examining the diffusion of cigarette taxation in U.S. states	It is suggested that cigarette taxation at the level of US states is influenced by interdependence between states. The effects of such influence, however, are not even across all states. Government ideology plays a role in determining the diffusion influence. It is argued that only those US states, whose governments are not right-wing, used the opportunity of being near higher taxed states to employ high cigarette taxes themselves. The concept of conditional diffusion is introduced to recognise the role of domestic factors in moderating interdependence.
Miller and Richard (2010)	States in the USA	2000-2005	Examining the diffusion of the R&D investment tax credit among states in the US	It is concluded that: (a) the main purpose of the adoption of R&D tax credit policies is for economic development. Policy-makers are motivated by the belief that R&D investment will create jobs; (b) States with more R&D activity are more likely to adopt R&D tax credits; (c) States with higher corporate tax rates are more likely to adopt R&D tax credits; (d) Single-party control of both chambers of the legislature and the governor's office makes the policy more likely to be adopted; (c)

Source	Regions/ Countries	Period	Research focus	Research findings
				States economically matched with other states are more likely to adopt the same policy than neighbouring states.
Prakash and Caro (2010)	14 communities in 3 cities in Massachusetts (US)	1990-2007	Comparing municipalities in Massachusetts that participate and do not participate in property tax work-off programs (TWOPs) by identifying factors affecting the adoption and the diffusion of the policy	Using Mohr's theory for adoption and Roger's theory for diffusion as conceptual frameworks this study offered the following explanation for the adoption and the diffusion of property tax work-off programs (TWOPs). In relation to the adoption of the program it was hypothesised that local governments were more likely to adopt TWOPs when they were motivated: (a) to help the senior homeowners; (b) to value the seniors' contributions, and (c) to meet demands from senior homeowners and advocate groups. With regard to the diffusion of the program it was hypothesised that TWOPs would be diffused successfully among the local governments which: (a) are able to afford to devote some financial and human resources for the initial launch; (b) perceive the relative advantages of a TWOP compared to the other existing property tax relief programs; (c) embrace the program's philosophy of valuing the contributions of senior homeowners; and (d) perceive the positive consequences of other participating communities. The results from the study support the hypotheses concerning both the adoption and diffusion of TWOPs. Factors such as significant benefits of the program, modest financial cost, and manageable administrative burden led to adoption of the program. Efforts to secure adoption of the program in nonparticipating counties/municipalities were constrained by insufficient financial resources and political support. With regard to the diffusion of the



Source	Regions/ Countries	Period	Research focus	Research findings
				<p>program, factors such as community attributes, program attributes, and availability of communication channels affected diffusion. The study also suggested the important role that local leaders played. Communities where the leaders were well informed about the program were more likely to pursue the adoption of the program.</p>
Sharman (2010)	19 countries employing national tax blacklists	Unspecified	Tracking mistakes in tax blacklists, to check for the presence and direction of this kind of “policy plagiarism”	<p>Policy-makers usually learn from successes and failures of others to craft better policy. It is claimed that national tax blacklists have been transferred internationally, but the lists have tended to lead to dysfunctional policy outcomes. The problem has been a non-reflective approach whereby the tax blacklist of one country are compiled through cutting and pasting from foreign models, copying existing mistakes in the process. While possible factors behind dysfunctional transfer might include coercion from epistemic communities (e.g. the World Bank or IMF) or the privileging of normative acceptance and legitimacy over technically efficient policy outcomes, these mechanisms did not seem to play a role in this context. The main factor contributing to this failure is the short-term political imperative to “do something” about tax evasion. This is particularly more acute in an environment of fiscal crisis and popular discontent. It is also suggested that adopting blacklists as an effort to protect a state from revenue loss seems unrealistic.</p>

Source	Regions/ Countries	Period	Research focus	Research findings
Jensen and Lindstädt (2011)	20 OECD member countries	1980-1998	Examining the international dimensions of corporate tax policy by exploring how tax policy decisions diffuse across borders	Different from existing theories of corporate tax competition, this study build a model of social learning to explain clustered tax policy cut. This approach allows differentiating instances of diffusion by social learning and diffusion by pure competition. It argued that corporate tax policy does not follow the pattern of pure competitive dynamics in international tax policy making: Governments do not simply cut corporate taxes because other governments have done so. Rather, governments attempt to learn new information from the policy of other governments and imitate them only when that information points to the viability of the policy. The authors concluded that although competitive dynamics can influence tax policy, the temporally clustered corporate tax cuts in the OECD, to some extent, have originated in social learning, not tax competition.
Seljan and Weller (2011)	States in the US excluding Alaska and Hawai'i	1997-2006	Examining how passed and rejected tax and expenditure limits (TEs) policy proposals in one state affect whether the policy is proposed in other states	It has been known that communication of information is the primary driver of policy diffusion. Previous studies, however, could not conclude what type of information influences policy diffusion. In this study, the authors disentangle political and policy information by analysing the effect of information on policy proposals. Political information provides information about the relative support for a policy (political viability), whereas policy information provides information about the effectiveness of a policy. The result concluded that the US states are more likely to propose TEs when their geographic neighbours have successfully passed the policies and less likely to propose TEs when their neighbours have rejected such policies. The negative effect of

Source	Regions/ Countries	Period	Research focus	Research findings
				neighbours' rejections indicates the flow of political information because rejections reveal no information about the policy effectiveness.
Barthel and Neumayer (2012)	19 selected countries signing double taxation treaties (DTTs)	1969-2005	Examining reasons behind the proliferation of double taxation treaties (DTTs), even when bilateral foreign direct investment (FDI) position between the two countries is asymmetric	It is found that the probability of a country signing a DTT with a given partner country increases if regional peers and foreign countries competing with the country in terms of exports have previously signed DTTs. However, that country is only influenced by other countries which export similar product rather than by those serving similar market. This means only the former group is regarded as competitors for foreign capital. It is argued that net capital importing countries find themselves in a 'prisoners' dilemma' situation. That is, while it is not beneficial for them as a whole to enter treaties with the standard provisions (i.e. OECD model treaty), each single country has an incentive to sign in order to gain a competitive edge in global competition for capital. Moreover, in order to offset its inferior position in the global market, a country has an even stronger incentive to sign a DTT with major capital exporters, if focal countries have signed treaties with them.
Squires and Lord (2012)	The United States and United Kingdom	2010-2011	Examining whether the introduction of Tax Increment Financing (TIF) from the US to the UK, as a spatially targeted economic development policy, was regarded as a policy transfer, and the capacity of policymakers and practitioners in an adopting country to make necessary	The study concluded that in the case of the adoption of TIF in the UK, the policy was more regarded as 'a modified policy "idea" rather than transfer' (p.817). The study identified twelve factors that were considered as key elements for the success or failures of Tax Increment Financing (TIF) policy transfer to the UK. Five are relevant to the present study: similarity of the problems, level of governance arrangements, political will, localism interest, and ease of

Source	Regions/ Countries	Period	Research focus	Research findings
			adjustments to encourage policy is adapted to the contextual circumstances of the policy's new environment	legislative change. The study also noted several factors that need to be considered when transferring a policy: (1) the involvement of stakeholders in drawing lessons; (2) the structural complexities of institutions, particularly in what rules are set in place; (3) the power relations of actors involved.
Ward and Cao (2012)	26 OECD member countries	1995-2004	Explaining geographical and temporal variation in green tax burdens by considering domestic and international determinants and modelling international influences using spatial lags	The authors concluded the domestic factors, the influence of other states' policies through policy interdependence, and the interactions between the two have contributed to the adoption of a "green tax" in a given country. The domestic factors included: special interest politics and the role of legislative median. Legislative median refers to the party (or parties) that dominates parliament (e.g. Martin & Vanberg n.d.). The authors did not find compelling evidence that the ideological affinity between states conditioned the reception of other states' policies. They argued that ideological affinity is only one factor that might condition the diffusion of <i>ideas</i> about policy. Diffusion, they argued, is likely to occur over various networks. In the case of "green tax", the networks link experts and economists, businesses, and the environmental movements. The authors also argued that in general, the closer two countries are in international networks, the more similar they are in terms of domestic economic policies because close connections facilitate policy learning and therefore policy diffusion. With regard to international factors, the authors found a contradictory conclusion about tax competition: Countries with structurally similar trade patterns do not appear to influence each other. What appears to matter for policy-makers was the

Source	Regions/ Countries	Period	Research focus	Research findings
				perception about a country's general competitive position, rather than having a competitive edge on other specific countries.
Christensen (2013)	New Zealand and Ireland	1980s and 1990s - 2000s	Seeking to account for the different extent of neoliberal reform in two "similar" countries	The study suggested that the diverging tax policy trajectories of New Zealand and Ireland—two small liberal market economies—since 1980 are not well accounted for by conventional ideational, partisan, or political-institutional explanations. It is concluded that the varying degree of neoliberal reform is better understood as the result of differences in the institutionalisation of economic knowledge within the state. It is argued that the policy role of bureaucrats is shaped by training through three channels: expertise, ideas, and identity. Differences in administrative institutions between the two countries have given rise to profound distinctions in the identities, expertise, economic ideas, and approach to policy advice of tax policy bureaucrats, which in turn had a major impact on tax policy-making. The author suggested that factors such as the political colour of the government, the political-institutional setting, and public opinion also played a role in policymaking.

## Appendix—C: Elements of BISEPS in the ATO Compliance Model

<b>B</b>	<b>Business</b>	<p>The extent and nature of the group’s business activities and transactions.</p> <p>Location and size of industry.</p> <p>Business plans and strategies.</p> <p>Entity and group structure.</p> <p>Capital structure, financial performance and ratios.</p> <p>Business age.</p>
<b>I</b>	<b>Industry</b>	<p>Conditions affecting the industry – region, seize and participants</p> <p>Industry associations.</p> <p>Industry profit margins and cost structure.</p> <p>Nature of the competition.</p> <p>Industry skill level.</p> <p>Impact of technological and business change.</p> <p>Financial performance.</p> <p>Industry norms and regulatory environment.</p>
<b>S</b>	<b>Sociology</b>	<p>Knowledge and norms of the professional/business group, e.g. standard of record keeping and lodgement timeliness.</p> <p>Culture of the organisation and management.</p> <p>Approach to community and corporate citizenship.</p> <p>How the group deals with finances and paying tax.</p> <p>Linkages to gatekeepers and advisers.</p> <p>Age of the HWI.</p> <p>Gender of the HWI.</p> <p>Education level of the HWI.</p> <p>Ethnic background of the HWI.</p>

<b>E</b> <b>Economy</b>	<p>Domestic, international environment and trade conditions.</p> <p>Key overseas developments.</p> <p>Government policies – interest rate, inflation, tax system and economic reforms.</p>
<b>P</b> <b>Psychology</b>	<p>Management of objectives and philosophy.</p> <p>Views and reactions of management to wider community.</p> <p>Approach to managing risk and drivers of the risk strategies.</p> <p>Attitude and relationship with the ATO.</p> <p>Trust</p>
<b>S</b> <b>System of compliance</b>	<p>Decision making system, process and organisational structure.</p> <p>Quality Assurance standards and records.</p> <p>The support and authority the corporate taxpayers' tax compliance team receives from management or from the HWI.</p> <p>The degree of ease in accessing information.</p> <p>Nature and purpose of transaction, e.g. value, type, conduct, methods, timing, costs and benefits.</p> <p>Compliance history.</p> <p>Tax analysis of issues and expected range of tax results.</p>

Sources: adapted from the Australian Taxation Office (2000a, p. 17) and Cash Economy Task Force (1998, p. 20).





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