

Anti-corruption and Corporate Tax Avoidance

Summary of Pan (2025)

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Outline

1 Summary of the paper

2 Comments

Motivation

- **The Problem:** Corruption undermines tax systems by enabling collusion and weakening enforcement, leading to lower effective tax rates.
- **Literature Gap:** Existing studies on corruption and tax avoidance rely heavily on cross-sectional correlations, making it difficult to establish causality.
- **Research Question:** Does international anti-corruption monitoring—specifically the **UNCAC peer review** mechanism—causally affect corporate tax behavior?
- **Hypothesis:** Peer reviews act as quasi-exogenous “soft law” shocks that increase the reputational risk and perceived cost of non-compliance.

Results

- **Increased Compliance:** Following the initiation of a peer review, firms exhibit a statistically significant increase in Effective Tax Rates (ETR) of approximately **1.9 to 3.2 percentage points** (6–12% relative to the mean).
- **Heterogeneity:**
 - The effect is strongest in **high-corruption countries**, suggesting international scrutiny compensates for weak domestic institutions.
 - Pronounced among **foreign-owned and large firms** due to higher sensitivity to global reputational risks.
- **Broader Impact:** The reviews are also associated with reductions in firm-level “tunnelling” (asset theft) and improvements in national tax revenue-to-GDP ratios.

Methodology

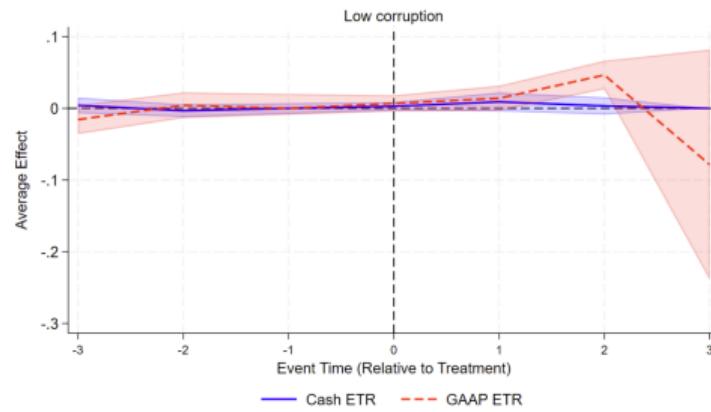
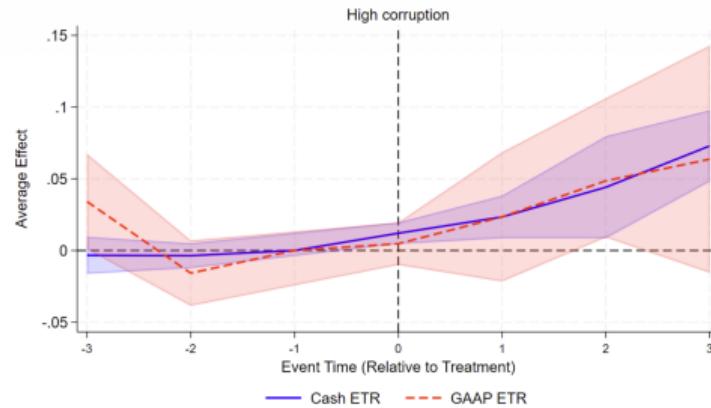
- **Identification:** Exploits the staggered, quasi-random rollout of UNCAC reviews (scheduled centrally by the UN) as an exogenous shock to enforcement.
- **Estimator: Local Projection Difference-in-Differences (LP-DiD)** is used to estimate dynamic treatment effects.
- **Why LP-DiD?:** Unlike standard Two-Way Fixed Effects, this method avoids negative weighting biases in staggered designs and flexibly maps the evolution of effects over time.
- **Controls:** The model includes firm and year fixed effects, along with time-varying firm (e.g., size, leverage) and country (e.g., GDP, governance) covariates.

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On firms in high / low corruption countries



- Purpose of this figure: Firms in high-corruption country respond positively within close window, i.e., +1 year, while firms in low-corruption country respond insignificantly at +1 year
- I believe most audience will immediately notice the **huge decline in GAAP ETR** in low-corruption country.
- What does that mean? Effective Tax Rate is lower? Or low-corruption country firms somehow is less compliant with tax code?

On the “lag” of the effects

- Most of the figures, either baseline results, robustness check, or heterogeneity analysis, seems to experience some **lag** of the effects.
- The effects mostly appears at **3+** years, rather than immediately.
- Why this lag exists? My understanding is that UNCAC shock is a one-time shock per country
- Perhaps such monitoring alleviates the complexity of the tax code in developing countries?

On the economics reason behind the heterogeneity analysis

- This paper has shown that the effect is larger among **foreign-owned and large firms** due to global reputational risks.
 1. I can relate to the intersection: foreign-owned firms in developing countries are probably multi-national firms, and thus they care about global reputation.
 2. What about domestic large firms? I conjecture the current result on large firms combines both foreign-owned and domestic.
 3. What about the joint ownership that happened a lot in China? Are the board members of those companies care about global reputation?
- For the difference between small and large firms, **financial frictions** may be a classical direction for testing.
 - Small firms are usually financially constrained; avoiding taxes may alleviate their funding scarcity
 - Large firms are less financially constrained or unconstrained, so they care more about global reputation, or say the ESG consideration among the supply chain