

# Does environmental tax evasion inhibit political sustainable development via firms' reallocation?\*

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## Abstract

It is noticed how corruption related to environmental policy influences pollution havens hypothesis. This is because corruption in developing countries may prompt polluting firms to locate in the country and to export pollution intensive goods. These firms could have the incentive of environmental tax evasion because governments in developed countries may impose additional tax rate on importing goods from developing countries with looser environmental regulation as Border Tax Adjustments. Quality of political institution in the country determines how easily these firms can evade the tax. Thus, the quality leads to influence exporting firms' entry and exit in the market. Here, the quality of political institution may determine what effect trade liberalisation has on pollution emissions via firms' entry and exit in the market. Analysing an R&D-based growth model with heterogenous firm's tax evasion, we investigate how environmental and trade policies influence economic growth and pollution emissions via changes in industry structure. Additionally, we investigate how changes in quality of political institution influence these policy effects. As a result of analysis, decreasing penalty rate leads to reduce environmental regulation level via tax evasion. This prompts local and exporting firms to entry in the market. It results falling economic growth rate and reducing pollution emissions between industries. Moreover, effects of trade liberalisation on global pollution emissions changes according to quality of political institution. This study suggests empirical studies that heterogeneity of firms' productivity may become important variable to determine pollution havens hypothesis related to corruption.

*Keywords:* corruption; trade liberalisation; pollution havens hypothesis; heterogenous firm; sustainable development.

*JEL Classifications:* F18, F64, H26, O30, Q56.

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