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Risk, Politics, and Tax Reform: Lessons from Some Latin American Experiences

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A. UNCERTAINTY AND THE NATURE OF TAX REFORM

One powerful organizing principle emerges from examining the politics of tax reform efforts in Latin America. The effective political[1] management of tax reform rests on the limitation of risk so that affected groups will be willing to bear some additional -- but predictably contained -- costs. This principle seems to go far in accounting for the tax reform experiences of Chile, Colombia and Peru, and seems to be consistent with other, more casually perused Latin American cases. In addressing the question of what it takes to accommodate the potential victims of a tax reform, we assume that accommodation that goes so far as to completely eliminate costs and risks is useless; someone must pay more or receive less benefits. Some accommodation comes from reducing the immediate costs that potential opposition has to bear. However, the most compelling imperative is to maintain a tolerable level of risk for the potential opposition. The successes in Chile and Colombia, and the frustration in Peru, bring out this principle quite clearly.[2]

This principle is clearly relevant only when the protestations and reactions of potential victims cannot simply be ignored. Occasionally the political calculations of a government intent on economic policy reform may be simplified by the powerlessness of the opposition, even if the latter stand to lose significantly. Following a revolution, an overwhelming electoral victory, or a system-transforming coup d'etat, a government may be able to dispense with accommodation. Yet, while such cases are conceivable for tax reform initiatives, and held to a certain extent for the 1974 Chilean tax reform, the ability to dispense with accommodation is unlikely in most circumstances. The multi-phase nature of changes in tax structure and tax implementation afford numerous opportunities to minimize or undermine the implementation and impact of tax changes. And these opportunities provide for the effective use of different sources of power -- electoral support; legislative strength; social prestige convertible into policy influence; money to buy votes, bureaucratic dispensations or to mount campaigns in opposition to policy proposals; and the potential to disrupt in reaction to unwanted policy changes. Given this diversity of resources to influence policy formulation and implementation, it is very unusual for the advocates of a particular reform to monopolize all the forms relevant to a process as complicated as tax reform. Therefore, without precluding the possibility of tax reform via force majeure, the tactician typically must face the need for some accommodation.

A1. Characteristics of Tax Reform and Its Risks

Several characteristics of tax reform yield the peculiar political importance of maintaining a tolerable level of risk. Some of these qualities are intrinsic to taxation and tax reform in general; others are more particular to the Latin American context.

1. The Redistributive Connotation Tax reform is typically perceived as redistributive. After all, taxation is the direct extraction of wealth from particular individuals and firms. Prudent interest group representatives could hardly operate on any other working assumption than that tax reform could redistribute wealth from them. Although all economic policy instruments have the potential to change the levels of income and wealth accruing to different individuals and firms, taxation is among the most blatant of such instruments. Tax reform, with its connotation of major shifts in the structure of taxation, is thus particularly likely to be seen as entailing major shifts in the burden of taxation. Thus, even though several tax reform initiatives have been undertaken with the explicit renunciation of intent to change the burden of taxation[3], so as to neutralize the perception that vertical redistribution was at stake, even these efforts are at best only partially successful. Typically, suspicions of a redistributive motive on the part of the reform's initiators are widespread and often justified.

There are peculiar asymmetries in the attitudes toward the redistributive potential of tax changes. For one thing, it is nearly impossible to find interest group representatives who leap enthusiastically into the tax debate in the expectation that they are likely to gain through redistribution. This is due, structurally, to the fact that there are so many steps between revenue collection and expenditures that no group can count on a sure and significant increase in benefits. It is very difficult to establish who benefits from governmental expenditures, let alone to anticipate who would benefit under uncertain future changes in expenditure policies. Moreover, the groups organized well enough to be involved in the tax debate (with the possible exception of labor unions) consist of upper-income businesses or individuals who are obvious targets for greater extraction. Where tax avoidance and evasion are common, the possibility of improved tax administration is also a threat -- though it may be offset by the opportunity for reducing both red tape and the need to pursue suboptimal tax-avoidance investments. Thus, even if tax reform may hold benefits for particular private interest groups, such groups typically operate in a basically defensive mode of damage control on the tax reform issue.

An offsetting factor, however, is that the redistribution perceived in tax reform can often be confined to the upper-income groups. Unless the government goes out of its way to arouse the organized labor sector, unions tend to be relatively inactive on tax reform issues.[4] Union leaders and rank-and-file union members act as if they assume that both their risk and their potential advantage in the typical tax reform are low. Whether this assumption is correct is debatable, since tax reforms frequently end up with heavier reliance on easily-collected payroll taxes. Nonetheless, tax reformers often have the luxury of proceeding without the full range of economic interest groups mobilized to exert pressure.

Finally, tax reform is distinctive as a redistributive issue in that both horizontal and vertical equity are involved and are highly interrelated. This is very important in that greater horizontal equity, a virtually consensual objective, can serve as the explicit objective of tax reforms that also have a vertically redistributive impact. Or, greater horizontal equity can be the "reward" for income classes that may lose through moderate vertical redistribution from the same tax reform. Moreover, existing horizontal inequality poses a risk of future reprisal for the individuals, firms, or activities currently subject to accusations that they are not paying their fair share.

2. Tax Reform as Innovation. A distinctive quality of tax reform is the potential for the introduction of new types of taxes. The potential for innovation is very high, and, while not unique to tax reform (new forms of government-guaranteed savings arise with great frequency), it differentiates tax reform from other potentially redistributive instruments. Land reform, price controls, credit regulation, and spending policy generally follow standard formulae; it is the magnitude that varies.

A large part of the desire for innovation of tax laws stems from the prevalence of poor tax administration. Poor administration leaves a huge gap between the theoretical yield of a tax and its actual yield. This means that a large part of the challenge of tax reform, and one of the major foci of the creativity mentioned above, is to devise taxes that will extract the desired amount of revenue with less reliance on tax administration.

Other implications flow from the distinctive "creativity" of many tax reforms. There is a strong appeal for the technical teams to exercise their ingenuity and sophistication. They are often engaged in professionally interesting experimentation, even if this experimentation is intrinsically risky for others. Tax specialists are often the champions of tax reform even when no private-sector group is willing to push for the reform.

Creativity also opens up a cat-and-mouse game between tax reformers and taxpayers. New taxes hold the promise of closing off prior avenues of avoidance and evasion, if only the tax formulators are more clever than the targeted firms and individuals. This is a game in which the taxpayers' economic standing is vulnerable to machinations by sometimes very clever tecnicos.

As a result of both of the above qualities, innovation creates uncertainty: a new tax has uncertain impact even without avoidance and evasion; and whether the taxpayers or the tax reformers succeed in closing the loopholes creates further uncertainty.

3. Poor Tax Administration, Uncertainty, and "Bureaucratic Politics". This uncertainty is, in a sense, increased by the common condition in Latin America of inefficient tax administration. Not only does poor administration provoke innovation of uncertain outcome, but also the question of whether administrative reform will increase tax burdens is an additional source of uncertainty.

Bureaucratic politics, pitting the tax administration bureaucracy against the technical team and the top-level economic policymakers initiating tax reform efforts, also puts the state bureaucracy at risk. Tax reform in developing countries is typically (but not always, given the current Chilean situation) an implicit affront to the competence of tax administrators. Their job tenure, let alone prestige, is at risk. Given the poor tax administration of most developing countries, the very initiative of tax reform typically puts the tax administrators on the defensive. Moreover, the reformers are often bent on making tax changes that require more difficult administration. Except for strengthening tax administration and moving to more easily administered taxes, tax changes represent additional burdens to tax administrators. When significant tax changes occur frequently, tax administrators find it difficult to consolidate and streamline their procedures; action to improve the administration of existing tax mechanisms can be crowded out by the scramble to meet new administrative demands.

However, poor tax administration does not necessarily increase risk to taxpayers. Inefficient (or corrupt) tax administration reduces the risk that a given initiative will require the payment of a surprisingly large increment in tax liability. With the latitude effectively permitted by poor administration, the taxpayer can, to a certain extent, adjust accordingly. By the same token, improvements in tax administration, as laudable as they might be in the long run, typically reduce the tolerance toward new taxes that imply possibly dangerously high burdens under improved administration.

4. Indeterminacy of Tax Reform Risk. Tax reform does not represent a pre-determined degree of threat to any particular group; indeed, the essence of the politics of tax reform is the indeterminacy of how much the reform can impact upon particular classes and types of taxpayers until the final details of formulation and implementation are worked out,

and the reactions of economic actors to the new tax regime have occurred. Taxation has the theoretical capacity to destroy a given taxpayer economically, yet tax reform may produce mild or moderate changes in tax burdens. Thus tax reform is not typically the ultimate threat as is the classic land reform. Tax reform may be less risky to a high-income individual or firm than other policy changes.

However, tax reform initiatives may have the effect of opening up other issues, such as the nature of property, that hold their own risk for various economic groups. Therefore some tax reform initiatives bear risk beyond the planned or predicted tax policy changes per se.

5. Taxation, Fairness and Illegality. The tax issue puts many individuals and firms into a peculiar vulnerability with respect to the legality and fairness of their current tax payments. A a seriously distorted tax system virtually forces many taxpayers into formal illegality in their tax declarations. They are thus subject to the risk of prosecution, even if evasion is widespread; in many countries the defense that "everyone else is doing it" carries little weight. These taxpayers, and those who represent them in the policy debate, are also naturally constrained from direct references to these transgressions. They typically cannot invoke counter-arguments to tax reform initiatives if their responses amount to admissions of evasion. For example, on one occasion (elaborated below) Chilean tax reformers enacted a huge increase in the value-added tax by arguing that an "honest" taxpayer would already have been paying that amount in transactions taxes. To cite the fact that hardly anyone had been paying that full burden would have been extremely awkward.

6. Involvement of Foreign Missions. The technicalities of tax reform lend themselves to the participation of foreign missions. These missions may be perceived as reducing the possibility that the government will enact a damaging tax reform. Sometimes the foreign tax mission will be seen as guaranteeing the fairness of tax reform changes. However, they may also be seen as an affront to economic nationalism, or as hired apologists for the government's preferences. Thus the contribution and image of the foreign technical mission add to the political context of the tax reform.

A2. The Broad Political Context

The uncertainty of the entire political economy is one component of the risk facing groups when a tax reform initiative is undertaken. Total risk involved in going along with a tax reform is a function of both the specific formulation of the reform in a particular arena and the overall political climate that might overrid the limits that seem to pertain to that specific initiative. The relevance of this distinction is that perceived risk may or may not be influenced by the tactics or design of the specific reform. For any case of success or failure, then, the reform design can be credited or blamed only to the degree that the macro-climate does not make the micro-analysis irrelevant. For example, if a key group believes that the government is out to destroy it, or that the government's own survival is in doubt, or that the government lacks the basic competence to carry out the reform in its anticipated form, then the details of the reform will make little difference to that group's behavior. Therefore, in assessing the tax reform initiatives in the three countries under examination, it is necessary to gauge the extent of perceived overall uncertainty in each case over time.

Colombia. The basic political situation in Colombia since the mid-1960s has reduced policy risk by dictating a preoccupation with avoidance of political polarization. The preference for radical policy departures existed in some quarters, but the likelihood that any administration would act on this preference could be assumed to be very low.

Although "on average" the two major political parties have shown little difference in policy preferences, there was (and still is) a wide divergence in the policy preferences among factions within each party. Thus a new administration, or at least some of the activists within it, might very well hold policy preferences that could present a threat to various economic interest groups. However, the imperative of avoiding destabilizing conflict was accepted by the top leadership of all major factions within the two parties.

This was because the specter of "La Violencia", the extreme instability and violence of the 1940s and 1950s, was still very much alive in the minds of the Colombian elite, even if by 1974 the political system had been stabilized. "La Violencia," like the Mexican Revolution, was the kind of nightmare of uncontrolled mass mobilization that drives political leaders into an overwhelming preoccupation with maintaining elite cohesion. The "National Front" arrangement of alternating administrations between the two parties had temporarily neutralized some of the inter-party political conflict, but the arrangement had come to an end with the 1974 campaign.

Under the National Front, severe policy swings were discouraged by the consideration that the other party would soon get its chance to retaliate. After the National Front, the need for cohesion remained, as the two traditional parties faced not only the possibilities that their own conflict would re-escalate, but also both electoral challenges from populist movements and the continuation of guerrilla activity.

The net result of this need to avoid open conflict with major factions in both parties was a built-in limitation on the extremeness of policy outcomes. Thus, with respect to the major 1974 reform discussed below, interest groups still had to worry that new policies might have extreme unanticipated consequences, but they also knew that Lopez Michelson and other top Liberal administration officials would moderate the intended impacts of policy. Thus the decision to use economic emergency powers to formulate the tax reform may have reflected Lopez Michelson's desire to end up with a tax reform (and a recognition that his rather left-leaning tax specialists ought to be allowed to have a tax reform), but the moderation of the reform through the Council of Ministers compromise process was a predictable political imperative.

Chile. Chile has shown the greatest variation in perceived uncertainty of the three countries examined here. For the period from the mid-1960s, the Frei administration (1964-70) was faced with a challenge from the Communist-Socialist Left that pulled Frei's own rhetoric, and many of his concrete initiatives, in that direction. In retrospect -- and in obvious contrast with the Allende administration -- Frei's policies were moderate, limited as they were by the middle-class basis of support for his Christian Democratic Party. Yet, when Frei sought to win over the labor movement, and when he unveiled his land reforms, spending program, tax reforms, constitutional amendment to redefine property, etc. -- all in the context of the seemingly open-ended reformism of the Alliance for Progress, it was very difficult for anyone to predict the limits of the changes under Frei, let alone the direction after Frei.

Moreover, the ability of the Frei administration to fine-tune its policy impacts was very much in doubt. Major policy departures were being won or lost, often on close votes, on the floor of Congress, rather than being hammered out -- and moderated -- in closed-door negotiations. So many changes were being implemented by a bureaucracy being pushed into an activist role that the usual assumption of bureaucratic resistance to rapid change could not be held with confidence.

Under Salvador Allende, whose presidency and life were ended in September, 1973, the only certainty was that drastic changes were afoot. Although Allende promised at the outset that the only targets of expropriation would be the "foreign exploiters and the monopolists," there were many other takeovers, often triggered by work stoppages designed to invoke a law allowing the state to intervene in firms with reduced production, and peasant land takeovers that were also validated by the state. Although the government's planners announced that 9.7% of national income was targeted to shift to wage and salary earners over the six full years of the Allende administration, nearly that much had been redistributed by 1972. (Ascher 1984:236; Stallings 1978: 56)

All of this came to an abrupt end with the Pinochet coup of 1973. The Pinochet government was certainly expected to redress the perceived economic injuries imposed on former property owners by the Allende administration. Chile entered into the period of greatest systemic certainty.

Yet even this clear reversal in the treatment of these groups did not spell out a definitive balance among economic groups. Many military governments in Latin America had populist leanings, and Pinochet, treading in unknown territory with a working class known to be highly mobilized and thought to be capable of open revolt, had to be mindful of both the risks of further antagonizing the low-income classes and the possible gains of a conciliatory stance. To be sure, Pinochet promised to "eradicate Marxism," but whether this meant crushing or wooing the working class was not totally clear at the time. Indeed, when Pinochet consolidated his personal power in 1981 in taking the position of President, the regressivity of previous economic policies was somewhat reversed.

And it should be kept in mind that the longevity of the Pinochet administration, now known in retrospect, was be no means certain at the beginning. It is easy to exaggerate the confidence that the Right had won for an indefinite period. It was not known whether the blue-collar and peasant groups that had backed the Allende administration would or could undermine any government economic initiative seen as highly retaliatory. It was not known when the transition to civilian government would occur, nor what the nature of that government would be.

Peru. Since the 1960s Peru has been an almost archetypical case of political and economic insecurity for nearly all actors. The APRA movement, of unpredictably populist orientation, won the 1962 election but was promptly ousted by the military. The Belaunde administration (1963-68) was widely viewed as more predictably progressive-reformist in its preferences, but Belaunde himself was regarded by many as a dangerously romantic naif when it came to economics. While few believed Belaunde to be a radical, there was great wariness about the possible misfirings of his economic policies, and doubt about who would end up bearing the burden of greater state expansion into economic activity and social services. This first Belaunde administration was punctuated by a misguided education expansion that practically bankrupted the treasury and a series of fiscal crises, exacerbated by congressional obstruction, that ultimately led to another military intervention in 1968, from which General Juan Velasco Alvaredo emerged as an enigmatic and seemingly contradictory leader..

This military government confounded the early predictions and launched the "Peruvian Revolution", a hastily constructed program of state-promoted mobilization of peasants and urban workers, expropriation of foreign property, and partial collectivization. If the Peruvian Revolution did not go as far as its opponents feared, it was not for lack of extraordinarily threatening rhetoric and seemingly irreversible challenges to the old economic structure. How far this revolution could have gone in the context of economic decline and the military's ambivalence about allowing truly independent mobilization of peasants and urban workers is much debated, but it is clear that the businessman, the labor leader of one of the non-government unions, and the landowner had no choice but to presume that he was facing a total threat to his entitlement.

When a more moderate military regime under General Morales Bermudez took over after the economic debacle of the Velasco period, there was probably much more confidence that the government was motivated to restore continuity and security. Nonetheless, the Morales Bermudez government was a transitional regime, and had little interest in raising the potentially threatening issue of tax reform. Hence, in order to maintain the feeling of security that Morales Bermudez would not further threaten beleaguered groups, the government was loathe to initiate any seriouis tax reform at all.

With the restoration of civilian government, Belaunde was again victorious, but economic chaos, a split government economic policy team, and the uncertain longevity of the Belaunde administration left economic groups as uncertain about the magnitude of threat they faced as during the Morales Bermudez years. Finally, the APRA victory in 1986 put a practically unknown young populist, Alan Garcia, into the presidency. It is widely believed that careful economic calculus plays a small part in President Garcia's thinking in comparison with political considerations, and that these political considerations conceivably could take a radical turn.

B. THE SEQUENCES IN COLOMBIA, CHILE AND PERU

By the mid-1960s, technical knowledge about Latin American public finance made it clear that radical improvements in tax systems were both important and technically feasible. Tax reform had been a priority of the Alliance for Progress planning, and many technical studies were undertaken by the Organization of American States and other standing and ad hoc technical bodies.

In the three countries central to this paper, the tax systems had some strikingly similar problems:

. Inflation was seen as an extremely pressing problem, and, although there was dissent both then and later, it was widely believed that the budget deficit was a major causal factor.

. Existing tax systems were universally condemned for their bewildering arrays of different rates, exemptions, and special categories, violating norms of efficiency, horizontal equity and vertical equity. Taxes were earmarked for specific purposes, private investment was distorted.

. Marginal direct tax rates were high, having been elevated in the previous struggles to increase revenues, but (because of exemptions and evasion) tax revenues remained inadequate.

Yet there were important differences:

. Although all three countries faced inflation, Chile's hyperinflation was a major problem per se for tax collection.

. The Chilean tax administration was already superior to the Colombian and Peruvian, and capable of rapid improvement.

. The size and depth of the technical expert pools were greater in Chile and Colombia than in Peru.

B1. Colombia

The most ambitious tax reform carried out in the three countries was the Colombian reform of 1974. It was ambitious not only in its drastic simplification of the tax structure, entailing unification of tax categories and elimination of myriad exemptions and special treatments -- the Chilean reform of the same year had the same objective -- but also in its explicitly redistributive thrust. Considering that Colombia was (and still is) a highly competitive political system with strong representation of high-income groups, the progressivity of the tax reform presents a fascinating political riddle.

Antecedents to the 1974 Reform. During the 1960s, fundamental tax reform in Colombia was far more an idea than a reality. However, when Carlos Lleras Restrepo of the Liberal Party assumed the Presidency in 1966, he initiated a major study of the tax system, with the expectation that a coherent set of recommendations would emerge. This culminated in the "Musgrave Report" (Musgrave & Gillis 1971), the results of two years of Colombian government-financed work by a mixed team of Colombian and foreign experts headed by Harvard economist Richard Musgrave. Apparently Lleras had no particular priority for a tax reform during his own administration. There had been a tax reform in 1966[5] that did little to streamline the tax system but did manage to increase revenues moderately, and taxation of increasing exports and imports also raised revenues. Yet counter-cyclical government spending led to an increasingly serious budget deficit. Lleras believed that a through and systematic study of the fiscal policy was overdue. The 1967-68 Musgrave Report was to be a blueprint for reform in the mid-1970s.

The Musgrave Report called for more streamlined, efficient tax collection in order to increase revenues and to do so more progressively. The tax reform was not conceived as subservient to other policy objectives such as control of inflation or the stimulation of investment. Naturally, it was asserted that a sound tax system was important for sound monetary policy and efficient investment, but the Musgrave Report did not advocate making any sacrifices in the integrity of the tax structure in order to pursue these other goals.

Whether the objective of greater progressivity was Musgrave's idea or that of the young, relatively left-wing Colombians on the study team is a matter of dispute. Indeed, the direct impact of the Musgrave Report is difficult to assess. The study was completed, the book was written, and the documents then sat on the shelf during the next administration of President Misael Pastrana Borrero (1970-74). However, two things are clear. First, the study was "on record" as evidence that a thorough technical analysis of the Colombian tax structure had been accomplished. Second, the study established the young Colombian participants as tax experts with standing, important for their subsequent reputations as much as for the experience they gained.

Yet, during the second half of the Lleras administration and the Pastrana administration, no fundamental tax reform efforts were undertaken. In the case of Lleras, it may seem surprising that there was no concerted effort to enact the reforms recommended by his own study mission. But, by the time the Musgrave Report was completed and digested, the Lleras administration was facing the decline in political power characteristic of single-term presidencies in their last years. Furthermore, Lleras' emphasis on the battle for classical land reform created so much hostility from the agricultural sector that this sector's acquiescence to tax reform (which was perceived as a stalking horse for further inroads against large-scale farmers and cattle raisers) seemed quite remote. Finally, it is possible (particularly given Lleras' later opposition to the 1974 reform based on his own mission's recommendations) that Lleras did not concur with the generality of impact on the higher-income groups that the Musgrave Report called for. Although Lleras' support for land reform and the taxation of landed wealth could certainly be construed as progressive in terms of income distribution, his support for and by the industrial sector was not consistent with greater taxation of industrial entrepreneurs engaged in import-substitution industrialization.

In the case of the Pastrana administration, the terms of trade for Colombia's exports improved markedly during the 1970-74 period (Perry & Cardenas 1986:61); the economy was expanding and so were tax revenues -- although increases in public spending led to a fiscal deficit. The tax side of fiscal policy may simply not have been the focus of concern for the Pastrana team. Politically, the Pastrana administration was in the awkward position of relying (in part) on the support of large-scale agriculture during a period of continued pressure for land reform. To relieve this pressure, Ley 3 of 1973 created, for the first time, a presumptive income tax on agricultural land. [6] However, the Ministry of Agriculture was given the authority to suspend the application of this tax for given regions and for a host of reasons. Given that in Colombia (as in many other countries) the Minister of Agriculture is traditionally drawn from the agricultural sector itself, it should not be surprising that the presumptive income tax on agriculture was suspended totally from that time until it was superseded by the tax reforms of the Lopez Michelson administration. Moreover, in compensation for this effectively fictitious presumptive income tax on agriculture, accompanying tax laws (Ley 5 and 6) expanded the exemptions and deductions for the agricultural sector more than for other sectors, even while tax retention on salaries and dividends was strengthened. (Urrutia 1986: 35; Perry & Cardenas 1986:18).

Even so, setting the precedent of a presumptive income tax for the agricultural sector was far from a trivial event. It would seem at first glance to open up a risk of indefinite boundaries. Yet the historical context gives it a very different connotation.

The greatest threat to the large-scale agricultural sector had clearly been land reform. Various governments, including the Lleras administration, had made land reform a high rhetorical priority, even if the actual redistribution of land was minimal. The land reform strategy up through the Lleras administration had been to offset the deprivation that land expropriation represented to the large-scale agriculturalists by granting them tax exemptions and other incentives justified in the name of productivity stimulation. This may have been a good deal for the large-scale agriculturalists, as long as the land reform did not go too far, but the risk represented by the apparently growing momentum of land redistribution was perceived to be great. If the government found land reform to be politically popular, there were enough other cases, ranging from Cardenas in Mexico to Allende in Chile, for landowners to worry about peasants and government encouraging one another to carry land expropriation further. Land takeovers by squatters, with what was seen as the implicit support of certain government agencies, were already not uncommon in Colombia. If the government shied away from significant land reform -- as seemed to be the case to that point -- then the danger of peasant disruption and land seizures in frustration with government policy was the other possibility.

Therefore, when an agrarian reform bill was blocked in Congress in 1972, a compromise more to the liking of the large-scale agricultural sector was reached through negotiations with representatives of both parties. The "Chicoral Accord" basically renounced land redistribution in exchange for the presumptive tax. (Bagley & Edel 1980: 277, 283; Urrutia 1986:38). Through this accord, the government reversed its stated agrarian policy from encouraging greater productivity through tax exemptions to fiscal extraction -- again in the name of promoting productivity, since the presumptive income tax was thought to encourage fuller land utilization -- in place of land expropriation. The presumptive tax was the lesser of the two threats. Moreover, large landowners knew that their representation in Congress was, and in all probability would remain, very strong. As long as the application of the presumptive tax remained partly under the control of Congress, the risk would also be limited.

The 1974 Liberal Party candidate Alfonso Lopez Michelsen made tax reform a prominent campaign issue. For Lopez Michelsen, the appeal of the issue was that it could be cast as an explicitly redistributive campaign, thus enhancing his populist reputation, and it provided the means to highlight the rising inflation that tarnished the preceding Conservative administration. Lopez Michelsen's lopsided electoral victory not only gave him enormous power, it also gave the issues of fiscal redistribution and inflation the prominence of electoral endorsement -- a vote for Michelsen could be read as a vote in favor of his campaign pledges.

The landslide also made it a foregone conclusion to the bulk of Colombian politicians of both parties that the Lopez administration could have its way on tax issues. Even if the usual legislative process afforded opportunities for opponents to snag the procedures, there was a legitimate[7] procedure of invoking economic emergency powers that could secure some degree of tax reform for the new administration. The questions were: how strong a tax reform; who would bear the burden; and at what political costs to the Lopez administration?

Immediately following the election, Lopez Michelsen established a technical team to develop tax reform proposals.[8] Many of the key participants had been members of the Musgrave team, and the Musgrave studies clearly shaped their approach to tax reform.

The experts' recommendations included:

.increasing revenues principally by raising overall sales tax rates -- but with five different tax rates distinguishing among goods according to whether they are consumed by the rich or the poor

.elimination of almost all income tax exemptions and special treatments for the oil depletion allowance, inheritance tax, capital gains, and previously tax-exempt government bonds and private financial instruments -- income from these sources was to be taxed at the marginal income tax rate

.substitution of tax credits for personal tax deductions, in order to eliminate the regressivity of tax deductions, which have a greater value for high-income taxpayers.

.higher top marginal rates for both income and net wealth

.automatic adjustments for inflation -- but not full adjustments, as the tax policy was intended to help control inflation.[9]

.a <u>general</u> presumptive income tax

.consolidation of treatment of different types of corporations

.assorted measures to improve tax administration.

According to the constitutional provisions regarding the economic emergency powers, all cabinet ministers had to agree to each decree. Understandings between the Liberal and Conservative parties on the transition from the National Front arrangement to strictly competitive elections still called for the President to include opposition party members in his cabinet[10]. Overall, the cabinet represented urban and rural interests, Liberal and Conservative outlooks (albeit not a major distinction in terms of policy in Colombia), and economic views ranging from center-left to center-right. Yet even the Conservative ministers in Lopez Michelsen's cabinet owed some personal loyalty to the President. And the deliberations within the closed-doors Council of Ministers kept out both formal party representatives and the interest groups. Therefore the process of policymaking under the emergency economic powers may have resulted in a compromise position, but it also greatly reduced the chances of avoiding stalemate and therefore no tax reform at all.

It was widely believed within the cabinet, even by the Conservative Party ministers, that Lopez' popularity and electoral margin made it inevitable that the tax reform, to which the President gave so much personal emphasis, would succeed. This, of course, became a self-fulfilling prophecy (in addition to being a correct political assessment), inasmuch as the ministers, even if they were philosophically opposed to the direction of the reform, believed that they had to come to terms with the President. Since the President was strongly committed to the direction of the technical group's proposals, the Council of Ministers' negotiations ended with all of the elements of the technical groups' recommendations, but with many of them moderated.

Following the technical work and the government's initial tax decrees under emergency powers (but still subject to modification and still vulnerable to Congressional rejection), top government authorities met with representatives of agricultural interests to mitigate the impact of tax changes on the large-scale agricultural sector.

The background to these meetings was that the technical team was known to be rather unsympathetic to the large-scale agrarian interests, in part out of prior commitment to land reform that pitted the large-scale landowners against the small-holders and the landless. For some members of the technical team, change within the agrarian sector, whether land reform or governmental benefits to the rural poor, could best be financed by taxing the wealthy within that sector. The organized agricultural sector responded, however, that this approach was a disguised form of continued industrial and urban bias, and that Colombian agriculture, of whatever ownership, would decline under significantly greater taxation. In addition, although the major executive policymaking authorities were widely believed to be antagonistic toward large-scale agrarian interests, Congress was seen to be just the opposite. Therefore the administration's leaders saw a need to soften both the inter-sectoral transfer and the political impact of the tax reform.

These consultations with agrarian interests did not yield very much significant change in the tax laws themselves. However, the practical impact on the agricultural sector was considerably softened by changing the rules of implementation. Most importantly, the planned revaluation of agricultural property was dropped. Since the agricultural interests feared most the implications of the presumptive income tax, the cancellation of property reassessment represented a major reduction in risk. The reduction in the presumed profit rate also lessened the possibility that an agricultural producer would have to pay taxes based on the presumptive income calculation beyond what would have been declared as earned income. The industrialists had even less to fear of the broadening of the presumptive tax to cover their earnings, since their ratio of earnings to property was typically well over 8%, and the possibility of plausibly reporting lower earnings was minimized by the better monitoring of industrial activity as compared to agricultural activity.[11] In short, what seemed to be a very frightening tax rehauling had some implicit but widely recognized constraints. The 1974 reform had enough of the Llerista attack on the landed property owners to assure the urban sectors that they were not the big losers. Yet it steered far enough away from land reform to placate the agricultural interests that things could have been much worse.

The net result was that the 1974 tax reform succeeded in introducing novel forms of taxation, simplifying the tax system, eliminating some loopholes, and increasing revenue. Its limitations included the relatively small contribution to overall revenues that the new forms of taxation made at that time, the perhaps inevitable failure to foreclose the long-term capability of the wealthy to learn ways to reduce their direct-tax liabilities, the administrative court's nullification of parts of the reform as impermissable under emergency powers, and the opening for later counter-reforms brought on by the tax system's remaining weaknesses in inflation adjustment.

The technical group planned to use the sales tax (applied progressively) to provide the bulk of increased revenues. This reliance on an existing tax was in keeping with the concern for reducing uncertainty and risk. While the future potential for using innovative taxes such as the presumptive income tax was established, the potential cost facing interest groups for the moment was concentrated in the much better understood behavior of the sales tax. At the same time, this also served to ensure the government of greater confidence that the changes would not erode revenues.

This increase in indirect taxation did not arouse much opposition from organized groups, despite the fact that it was to be both progressive and the major source of new revenues. Manufacturers could pass through to the consumer, as indeed happened (Urrutia 1986: 46) However, some decline in the demand for more heavily taxed luxury goods could be expected, adversely affecting some manufacturers, and certainly a decline in the purchasing power of high-income consumers.

The lack of opposition can be attributed to three factors. First, fighting the sales tax was not a good "consumer" issue.[12] The only potential defenders of the "general consumer interest" were the unions and the political parties. Neither had a strong motive to object to a sales tax weighted heavily against luxury goods. The opposition party also had minimal power following its electoral defeat. Thus, the ensuing rapid (though short-term) inflation was criticized, but there was no concerted attack against the sales tax per se by the unions or the political opposition. Second, high-income consumers were simply not organized along the lines appropriate either to identify a progressive sales tax as a serious threat or to fight such a tax. Third, although the economic emergency powers still required ultimate Congressional approval, they did reduce the intermediate steps of committee hearings in which interest groups could have had more input. As long as Lopez Michelsen could sell the package to the cabinet, and gain final Congressional approval -- a task aided greatly by his electoral popularity -- he could bypass much of the public protests by interest groups.

The overall absence of effective opposition (other than loud complaining by most business and agricultural groups) was, however, matched by a striking lack of enthusiastic support from any non-governmental quarter. Although Colombian labor unions are not controlled by the major political parties, and typically have ideologically radical-leftist leadership, their participation in the debate over tax reform has been minimal, except when the reform seems to pose a clear threat to their economic standing. (Urrutia 1986:60) In 1965 there had been successful general strike to protest tax changes that were seen as strongly regressive. Yet since that time, the apparently progressive tax reform initiatives have elicited little support from the labor sector.

Even without labor support, though, the government did not bow to the protestations of business and agricultural gremios. President Lopez simply announced that the emergency did not permit policy changes to respond to their complaints, and rejected appeals to hand the tax reform over to a tripartite commission that would have given the business sector a direct corporatist role in formulating the reform package.(Urrutia 1986:65) Thus, although the tax reform was redistributive along class lines, it was not won through anything resembling a struggle among classes. Rather, it was the state versus the business sector, and the former used the President's power and the mechanism of the emergency decree to carry the day.

Results and Denouement of the 1974 Reform. As planned by the technical group, the sales tax, rather than the presumptive income tax on agriculture, yielded the greatest revenue increases. Since this sales tax was indeed made progressive through the different rates applied to different goods categories, it was a clear-cut example of a progressive indirect tax.

The streamlining of the income tax also yielded significantly higher revenues for the first few years. The general presumptive income tax, which clearly went beyond the Musgrave Commission's recommendation of an agricultural presumptive income tax, was not only very popular politically but also produced very large yields in the first two years. (Perry & Junguito 1978). Yet the increases were not permanent. For one thing, the failure to revalue agricultural land reduced the bite of the presumptive tax. For another, high-income taxpayers managed to reduce their tax burdens by avoidance or evasion. (Urrutia 1986: 45; Perry & Junguito 1978) This was a good example of the limited half-life of reforms on direct taxation.

With respect to the failure to adjust fully for inflation, the Colombian reform represents an example of trying to do too much with a single policy instrument. Several members of the technical group had argued strenuously in favor of full inflation adjustments, and retrospective analyses of the 1974 reform point to this as its biggest mistake[13] ; the subsequent distortions due to "bracket creep" were so great that tax relief measures in 1976, 1977, and 1979 were strongly backed, thus providing the opening wedge for other measures that watered down the force of the 1974 reform. Each of the tax relief measures prior to 1979 provided for only partial adjustment for inflation -- only the 1979 changes enacted 100% adjustment. Thus, from 1974 up to the 1979 change, tax policy was partially directed to combat inflation. at the cost of jeopardizing the effectiveness of the tax system itself.

But this was more than a simple technical blunder or a case of trying to do too much with a single element of economic policy. Since the 1974 election campaign had focused on the problem of inflation, and the tax reform itself was rationalized as an anti-inflation measure (on the argument that inflation was due to the budget deficit), there was strong pressure on and by the Minister of Finance to try to use tax policy as another weapon against inflation. The rhetorical linkage of the two issues ultimately had some undermining effect on the coherence and persistence of the 1974 reform.

In accordance with the Colombian constitution, the emergency-power decrees were also subject to scrutiny by the Supreme Court to assess their constitutionality. Interestingly, the provisions struck down by the Supreme Court featured changes in procedures of tax administration, on the questionable (Urrutia 1986:53) grounds that the economic emergency had nothing to do with tax administration but rather with overall revenue levels. In this case, and later with the 1982-83 reforms, there seemed to be an unstated understanding that a serious tightening up of tax administration would have been a more drastic step -- and much more threatening -- than a change in the tax rates and even in the types of taxes!

With respect to tax administration, the curious denouement of the 1974 reform was the uproar when Guillermo Perry, a leading expert in the technical group and newly appointed Director of the National Tax

Administration, tried to gain greater administrative compliance by placing his own team into this bureaucratic structure. The old guard within the administration and several opposition politicians protested that Perry was trying to "infiltrate" the tax administration with leftists. After a "strike" by some tax administrators, Perry was reassigned. The idea that tax administrators could constitute a leftist threat may seem curious, but in fact lax tax administration was a feature that, along with the elimination of many exemptions, kept the high marginal income tax rates (raised to 56% for the top group by the 1974 reform) from being confiscatory.

The Colombian Reforms of 1982-86. The 1974 tax reform was so strong that it triggered several counter-reforms through 1980. The need for revenues kept the changes to a rather modest level in terms of overall tax incidence, but the changes, justified largely on the need to relieve the distortions due to the inadequate treatment of inflation adjustments, did dilute the coherence of the 1974 reform (Urrutia 1986: 69). Thus the reform launched in 1982 was initially designed to restore coherence, not to increase revenues or change the vertical distribution of tax burden. Ironically, the 1982-83 reform was successful in terms of increasing revenues, but made less progress than anticipated in restoring the coherence of the 1974 reform. The reform went through despite the fact that the Supreme Court ruled that tax policy was too important, and of too long duration, to be subject to executive authority under emergency powers. Although the administration of newly-elected President Belisario Betancur initially feared that tax reform pursued through the legislative route would be sabotaged, it was indeed enacted through the standard Congressional procedures.

The context was, first, the effort to re-shape the tax structure to improve its technical performance, and, second, an unexpected fiscal crisis brought on by the unprecedented rise in real interest rates for foreign borrowing, posing the danger of both severe recession and a frightening fiscal deficit that, without increased revenues, would require highly inflationary financing. Betancur was hampered by the fact that his electoral victory was not a landslide, and he had not campaigned as an advocate of a stronger tax effort. Indeed, Betancur had promised the industrialists relief from double taxation and promised lower tax rates to the public (Perry and Cardenas 1986:277-278), yet the immediate crisis required both action to reduce inflation and a reactivation of the economy.

The administration established an advisory commission attached to the Ministry of Finance, charged with the task of suggesting how tax revenues could be increased rapidly and economic recovery could be stimulated. Because a team had been working on a tax-reform analysis, the work of this commission did not have to proceed in a vacuum. Much of the analysis reflected in the Betancur commission's recommendations had been done by a technical team operating under the previous administration, aided by external technical advisors (in this case a team of the Inter-American Development Bank)(Urrutia 1986: 54). The internal Colombian tax commission established under the previous administration was initiated by the Director of National Planning, Eduardo Wiesner, who had been a member of the Musgrave Commission.

However, the purposes of the tax changes had shifted from streamlining as the only principal objective, to increased revenue collection as the prime objective. When Wiesner had been Finance Minister under President Julio Cesar Turbay, he followed the stance taken by Turbay's earlier Finance Minister, Jaime Garcia Parra, that taxes ought not be raised further, but rather the system of inter-governmental transfers should be rationalized. Foreign loans had been available at very attractive real interest rates, which led both Finance Ministers to resist absorbing more private income when foreign capital seemed so cheap. Therefore the economic situations confronting tax reformers before and during the 1982 crisis were quite different. It is quite significant that the analytic preparation could be accomplished even though the short-term objectives of the reform had changed.

Initially, the Betancur administration planned to proceed, as with the 1974 reform, through economic-emergency decrees. In fact, the economic emergency was more acute in 1982-83 than it had been in 1974. Over the strenuous objections of some of his own cabinet ministers, Betancur approved a series of emergency decrees. While many of the recommendations of the advisory commission were accepted, there were also significant modifications, basically providing exceptions to specific industries (e.g., housing) and to agriculture (the 1983 measures actually reduced the burden of the presumptive tax on agriculture (Urrutia 1986:69)) that were opposed by the commission on the grounds that they detracted from the coherence of the tax system (Perry & Cardenas 1986: 278).

The economic emergency decrees were annulled by the Supreme Court. The 1974 episode had shown that tax reform could have very long-lasting impacts, and hence was much more than an emergency response to the crisis of the moment. Therefore, the Supreme court ruled that the economic emergency decrees were not appropriate for tax reform. Then, too, there was much less conviction that the Betancur administration could get its way on tax reform, whereas the overwhelming electoral victory of Lopez Michelson had made it clear that, one way or another, Lopez' tax reform would go through. Thus in the Betancur case, the resort to emergency powers seemed to be a tactic that could change the basic outcome, and therefore was of more questionable legitimacy, whereas in the Lopez case the only difference in outcome was that the result was likely to be somewhat more coherent.

President Betancur responded to the Supreme Court ruling by reverting to the normal channel of Congressional approval and opening up a public debate on the tax reform. The result was that the gremios made greater inroads in getting modifications in the reform package, and therefore did not press Congress to the same degree as they would have if given the opportunity in 1974. Even so, Congress was surprisingly accommodating to the Betancur reform, especially in light of the fact that it was dominated by the opposition Liberal Party.

This time the industrial and commercial associations (gremios) felt the threat. The 1974 reform had been seen as directed against the agricultural sector, and the adjustments of the mini-reforms of 1977 and 1979 had favored the industrial sector by alleviating "double taxation." But the 1982-83 changes were clearly not going against the agricultural sector, and by 1983 it was clear that the reform would have to increase revenues from some source.

The business sector's response was extremely negative and combative. As in 1974, the associations of all sectors opposed the changes in the procedural tax laws that would make evasion more difficult. The industrial sector's explicit attack on the tax reform was that it reduced horizontal equity through inconsistent treatment of profits and financial loans (Perry & Cardenas 1986: 279), and its macroeconomic effect of worsening the recession.

Many Colombian observers explain the business sector opposition by pointing out that the "carrot was smaller than the stick": the promised relief for "double taxation" did not make up for the elimination of existing exemptions and higher tax rates. However, there is a different explanation that seems to capture the mood more accurately. Once it was clear that the fiscal emergency would negate the government's campaign commitments, and that the tacit commitment to revenue neutrality was abrogated, the business sector faced a risk of unpredictably higher tax burdens, and thus the <u>gremios</u> attacked the reform with full force. What had started out in 1982 as an initiative for horizontal equity became, in the eyes of the business sector, a hurried and open-ended reaction that entailed considerable risk to the profitability of industry and commerce.

The reason why the reforms went through Congress despite business sector opposition illuminates not only why it is essential to distinguish between political and economic-sectoral groups, but also how important the timing of reform is to gaining the support of the political opposition. The Liberal Party, lacking executive control but with bright hopes for 1986, became interested in changing the regime that gave rise to expectations that a budget deficit could be financed through monetary emissions -- and in getting the change enacted under a Conservative regime so that the austerity effects could be laid to the Conservatives. A newly established Interparliamentary Fiscal Commission of the Liberal Party announced its commitment to the principle of forbidding inflationary deficit financing in 1983. If the government succeeded in its reforms, future fiscal management would be easier for any government; if the government did not succeed, then the standing of the Liberal Party would be all the more strengthened in the contrast.

Congress actually eliminated some of the exemptions that the President had allowed for particular bank deposits, some of the relief for double taxation, and hastened the application of the value added tax. Yet it also allowed for exemptions that the administration opposed for agriculture (reflecting the well-known pro-agricultural tendencies of the Colombian Congress), automobile purchasers, and oil and mining companies. (Perry & Cardenas 1986: 281) Thus, from the Congressional perspective, especially that of the Liberal Party Congressmen, the tax reform resolved the short-term revenue crisis, made progress on long-term safeguards against inflation, acceded to some of the most effective business-sector pressures, and left most of the business-sector antagonism targeted against the Betancur administration. The costs to Betancur of introducing the tax reform as an open-ended threat were, first, the incoherence of the reform that resulted from having to accommodate the high level of mobilization of opposition by industrial and commercial groups; and, second, the erosion of political support that Betancur otherwise might have expected from the business sector with respect to all of his other policy initiatives.

The tax laws passed by Congress also introduced greater flexibility to the administration than had been requested to revamp the sales tax in order to bring the system closer to a coherent value-added tax. With the technical support of both the Inter-American Development Bank and the Organization of American States, the administration extended the VAT to the retail level. (Perry & Cardenas 1986: 282) The immediate response was a threat of non-compliance by the large-scale retailers' association FENALCO, which claimed that the measure would violate horizontal equity in placing a lesser burden on smaller retail establishments that could get away with evading the tax, and that it would be inflationary. Betancur's response was to force the retailers to choose between the lesser and greater threats: he offered to introduce the retail level VAT gradually, but promised to punish severely any defiance of the new tax regime. The gremio moderated its opposition.

The Post-1974 Colombian Reforms. Two more "tax reforms" in Colombia are worth touching on briefly. In 1984 the Minister of Finance Roberto Junguito went to Congress with a series of ad hoc proposals to increase tax rates in order to meet World Bank and International Monetary Fund conditions. By invoking the need for an austerity program, Junguito was able to effect an increase in real revenues of over twenty per cent by 1985. In a sense, the administration appealed to the nationalistic sentiment to avoid being placed in a vulnerable position vis-a-vis these international agencies. In another sense, the Bank and the Fund played the role of prodding the Colombian politicians to carry out the major increase in revenues (and marked improvement in the fiscal balance) that otherwise might have provoked another bitter fight.

Finally, the 1986 tax reform initiative of the new administration of Liberal President Barco represents another illuminating demonstration of the management of risk and uncertainty. The government had swept the presidential election with a majority of 2 million votes, giving it a far greater mandate than the preceding Betancur regime. This left President Barco in a position similar to that of Lopez Michelson, in that a sweeping reform, if so desired by the president, would have had the force of a landslide victor.

Yet this time the President began with an open process, rather than having to open up the debate on a controversial reform that had already raised hackles because it had been developed strictly from within the administration and pursued initially through decrees. Instead of trying the economic emergency route -- which would have had no plausibility in 1986, in any event -- Barco initiated the deliberations over the reform through an Advisory Commission of the Liberal Party, which involved party members who informally represented practically every organized sector. Moreover, Barco had a better balance of carrot and stick than Betancur, even though Barco had more power; the pursuit of greater efficiency of the tax system through further elimination of exemptions and special treatment was balanced by lowering of the top marginal tax rates to thirty per cent. Thus the Barco reform was both the least costly in terms of the erosion of the President's power and good will, and, according to many observers, more successful than Betancur's in terms of surviving intact through the Congressional process. Of course, one could argue that the Barco agenda itself is less ambitious and therefore less threatening to the interests mobilized on the tax reform issue.

The 1986 initiative also raised the issue of balancing the capability of the tax administration with the "theoretic" advisability of (and, in the Colombian case, political mileage accruing to) further tax reform. After substantial reforms in 1974 and 1982, as well as many more modest changes in other years, the question of whether improvements in the tax laws were causing administrative confusion in tax implementation became part of the debate. The Controller General published several articles calling for a moratorium on new tax reform. He argued that the success of tax changes in Colombia ov r the previous twelve years had resulted in satisfactory legal provisions that now required consolidation and improved administration. Here we see a signal from the state that the further pursuit of tax reform was yielding diminishing returns.

Lessons of the Colombian Reforms

The Colombian successes at tax reform show that although the government may be the initiator of the tax reform initiative, the reduction of risk to non-governmental groups calls for finding a way for these groups to express their concerns within governmental policymaking. As noted in the introductory section, in Colombia there is a striking certainty (relatively speaking) that an administration must balance its policies to avoid antagonizing its multi-class, multi-sectoral constituency. Through the Council of Ministers negotiations of the 1974 reform, various interests were inserted through the views of the ministers identified with them (e.g., agriculture and big industry). Through these discussions some of the measures were moderated, especially with respect to the agricultural sector, but certainly not eliminated. This was, in a sense, a two-way street: the presence of sectoral spokesmen in the cabinet, such as the former president of the Cotton Growers Federation and a former senior administrator of the Coffee Growers Federation, also made it more difficult for the agricultural associations to oppose the measures. The 1986 Liberal Party deliberations accomplished the same function.

The Colombian case also tells us that even bombshells have to be carefully manufactured before they are dropped. Although President Lopez Michelson implemented the tax reform under "economic emergency powers" and as part of a "Stabilization Plan", the groundwork had been laid by years of work by Colombian economists and a major foreign tax mission (the 1967-68 Musgrave Commission). The relevant governmental policymakers were engaged in working out the details of the executive's reform proposal well before Lopez' inauguration and the selection of his cabinet (Urrutia 1986: 34). Similarly, the 1982-83 reforms benefited from considerable prior analysis even though the purpose of the reform changed from the time of Betancur's inauguration to the specific formulation of the tax reform package.

Although poor tax administration is generally taken as a given, in fact it has a politics of its own, both as "bureaucratic politics" and in terms of the broader political economy. It is important -- though perhaps ironic -- that the weak tax administration strengthens the political prospects of tax reform by reducing the risks. In Colombia, for example, it is commonplace to shrug off the possibility of being unexpectedly burdened with a much greater tax burden by saying that one decides beforehand on one's "fair contribution" and adjusts one's tax return accordingly. Naturally, such adjustment or evasion has its limits. The tax administration can find some flagrant evasions and prosecute then, perhaps as examples. For large firms, even a weak tax administration can afford rather careful monitoring.

Even though the Colombian tax reforms have been accompanied by their share of confrontation and combative rhetoric, it is important to note how regularized tax reform has become in Colombia. By 1986, periodic tax reforms in Colombia seemed to be a political staple -- a politically rewarding way for the government to project itself as activist and responsible in economic policymaking. This represents an interesting counter-example to Urrutia's (1983:45) complaint that there is no political mileage in tax reform.

The passage of tax reforms under powerful presidents raises a very interesting and important issue of policy appraisal. If the tax reform was an "easy thing" given the political climate and distribution of power, the sense of economic emergency due to the rise of inflation, and the traditional power of a Colombian president elected by an impressive majority, then it does not make sense to call the tax reform a political success simply on the basis of its enactment. While we may still usefully ask what it is about Colombia or about that particular era that made tax reform politically viable, those questions do not address the issue of whether the government's strategies can be considered effective and efficient. For that sort of question, we must use the more demanding criterion of whether the political, policy, and economic costs to the government and the country were minimized in bringing about a reform of given benefits, or the even more demanding criterion of finding the best cost-benefit result.[14]

For example, the 1974 Colombian tax reform, though justified as a means of reducing the fiscal deficit, was accompanied by an expansion of social expenditures and marked increases in the wages of state employees. Whatever one thinks of the advisability of these changes, they certainly diminished the achievement of the stated priority of controlling the fiscal deficit. If deficit reduction was a serious objective of the Colombian government, <u>and</u> the increased expenditure was part of the price that the government paid for the political support for the tax reform, then the reform must be seen as a somewhat less impressive political accomplishment. Similarly, many Colombians believe that the combativeness of the government's approach to forcing through the tax reforms of 1974 and 1982-83 shut off other opportunities to pursue reforms in other areas, because economic policymakers felt that they could not afford to antagonize the agricultural and business sectors any more than they did with these tax reforms.

Finally, the Colombian case tells us that there may be tradeoffs between the reliance on open, normal policymaking channels and the technical coherence of the resulting tax structure. There seems to be a consensus in Colombia that the 1974 tax reform, whether or not judged to have the correct objectives, was more coherent for its circumvention of the normal congressional modifications than subsequent reforms that went through the full congressional process.

B2. CHILE

The tax reform experiences in Chile span the political conditions of competitive democracy and military dictatorship; very low and relatively high levels of contextual certainty. In the Chilean case, the level of certainty, imparted either by the broad political context or by the specifics of the tax reform initiative, seem more important in accounting for the degree of success than does the nature of the political regime.

In Chile, unlike Colombia, all three major tax reform efforts that achieved a modicum of success (under Alessandri in 1964 and twice under the Pinochet administration) were conceived by their initiators as neutral with respect to both income distribution and the volume of government revenues at the time. (Arellano and Marfan 1987: 20). That is, although it was surely known that improvements in the tax system would ultimately have impacts on the capacity of the government to alter the distribution and overall level of taxation, such changes were not explicit objectives of the tax reforms. It was left to the annual changes in the tax law to shift the total volume of tax revenues or the distribution of the burden. In contrast, the two major "open-ended" efforts at tax reform under Eduardo Frei (1964-70) and Salvador Allende (1970-73), while they had very significant impacts on tax burdens, were not successful tax reforms in the sense of bringing either coherence or improved types and structures of taxation.[18]

Jorge Alessandri, a center-right president, approached tax reform near the end of his administration with the objectives of establishing a better basis for tax administration. This may seem like a very modest goal, but in retrospect it permitted much more ambitious reforms later on. And unlike most "streamlining" efforts at tax reform, the Alessandri reform created further distinctions in tax-treatment categories of incorporated and unincorporated firms. Preferential treatment was given to income earned by incorporated firms, in order to reduce the number of the less easily monitored, presumably more evasion-prone unincorporated firms. Many incorporations resulted from the tax law change (which was a governmental objective for other reasons as well), but there was no discernible immediate decline in tax evasion (Arellano & Marfan 1987: 21). While the new distinction between incorporated and unincorporated profits implied greater complexity, the reform also reduced the number of separate treatments for different sources of income from six to two: profits and labor. Other simplifications in the reform included the elimination of tax exemptions viewed as having outlived their usefulness as investment incentives, yet the reform was not conceived as a total overhaul as were the later efforts under the Pinochet government.

Two notable features relevant to risk-reduction can be detected in the 1964 reform. First, after the reform initiative had been examined and debated in the Chilean Congress for two years, the time was drawing near for a new administration. By 1964 it had become obvious that the Christian Democratic Party and its leader Eduardo Frei would assume power in the following year. The Congressional followers of Frei could therefore see the tax reform as cleaning up problems that otherwise would have to be handled, at some political loss, by the incoming administration.

Second, the reform initiative was presented and pursued as a project that would not change the vertical progressivity of tax incidence. The Alessandri tax reform was presented as improving efficiency without depriving anyone. To the considerable degree that Alessandri could convince private-sector groups that the tax reform was sufficiently justified as an effort to bring more coherence to Chile's confused tax structure -- and hence not a pretext for redistribution -- and that the administration could formulate a tax reform without major surprises in terms of effective incidence, the distributionally-neutral initiative presented little risk.

Frei himself had more ambitious goals for tax reform. He oversaw a major expansion of governmental spending to respond to the challenge of the Marxist Left. To finance this spending without disastrous inflation clearly required a dramatic increase in government revenues. By the same token, Frei made it clear that the changes in taxation were intended to increase the relative burden of the "upper classes" (Sigmund 1977: 50; Ffrench-Davis 1973: 252, 329).

Frei's first tax reform initiative in 1964 was presented to a legislature still dominated by the opposition of Alessandristas and the Left. Invoking the anti-inflationary objective, the tax package included across-the-board increases in tax rates. Frei also emphasized reducing the budget deficit by intorducing new spending programs only with adequate provisions for their funding (Arbildua & Luders 1968: 37). Since this meant violating the stricture against "earmarking" taxes - classic principle of organic tax reform -- it is worthwhile to explore the political rationale for this action.

Earmarking taxes to specific funding obligations affected the policymaking structure by intensifying the interests of the beneficiaries of any given measure and limiting its burden for the general tax-paying public. Of course, the whole set of earmarked taxes could entail a much greater tax burden, but on any given measure the support from potential beneficiaries was intense and the opposition diffuse. The cost of this tactic is that by making explicit connections between specific taxes and specific expenditures, the directly redistributive nature of taxation becomes all the more obvious.

Linking specific taxes to social-service expenditures would seem a risky approach, considering the ability of the rich to obstruct legislation. Yet for Frei (unlike Belaunde in Peru, who faced a similar challenge), two factors tipped the balance in favor of seeking separate financing for programs in education, health and housing. First, the budget process allowed for considerable political credit to redound to the Chilean Congress only when new funds were created. Second, the middle-class groups that would administer or supply the goods and services for extending social services to the poor could be expected to support not only the expenditures but also the taxes clearly linked to them. The result was not a confrontation between rich and poor, but rather between a coalition of social-service recipients and middle-class service providers, and the particular interests threatened by the specific tax obligations involved in greater expenditures.

The Frei administration also introduced a far more controversial Chilean version of the wealth tax (impuesto patrimonial) on the presumed income of capital assets including real estate, vehicles and company shares. The wealth tax revenues were earmarked for a broad "program of transformation" for health, education, housing and agrariam reform. The tax was to apply to individuals with incomes at leat nine times greater than the minimum wage, at rates from 1.5 to 3.0 percent of the assets.

The Right in Congress objected to the entire tax package, but especially to the wealth tax. A campaign was launched to convince the public that the wealth tax would apply to peasants and small proprietors, when in fact its incidence would have extended to only 3 percent of the population. The campaign did indeed create considerable furor, and contributed to the defeat of the tax package in 1964. On the other hand, the defeat of the tax legislation in 1964 contributed to the strength of Frei's appeal for a legislative majority in the upcoming elections.

The wealth tax proposal opened up the highly contentious issue of the legal and even constitutional status of private property. Since the tax reform initiative was accompanied by both a government-sponsored land reform initiative and the openly-discussed plan of the Socialist and Communist Left to transfer industrial property to the state, the risk of permitting a change in the status of property, even if ostensibly only for the purpose of a mild tax, was seen as very great in broader perspective. Not even the likelihood that such a property tax could easily be avoided or evaded was enough to soften the opposition.

Moreover, the broad Frei project of increasing the state's role in both social spending and direct economic activity had no discernible ceiling when viewed by the private business sector. Frei seemed to be intent on preempting the appeal of the Left by expanding the state to an unpredictable magnitude. The tax reform was overtly geared to increase the burden on higher-income groups, and whatever technical corrections were entailed were viewed as serving that end rather than the more politically neutral end of the Alessandri reform.

When Frei resubmitted the tax package in 1965, it still could not gain passage intact, despite a Christian Democratic majority in the Chamber of Deputies. At this point (in contrast with Lopez Michelson in Colombia), Frei decided that a confrontation over tax reform would jeopardize the success of the other contentious objectives of economic redistribution, namely land reform and nationalization of copper. Frei's Finance Minister Sergio Molina (1972: 127) later wrote:

> The governmental measures were consciously designed <u>not</u> to open many simultaneous fronts in the struggle [for income redistribution], because it was known that the affected sectors would become tenacious enemies out to frustrate them.

Therefore the Frei administration accepted several dilutions to the wealth tax: it was restricted to 1965; the rates were cut back to 1.2% - 2.1%; and other tax liabilities were deducted from the wealth-tax base. Yet later that year an earthquake and flooding occasioned a reconstruction program that secured funding through an extension of the wealth tax at rates of 1.6% - 2.8%. In 1968, when that tax expired, the wealth tax was again legislated, albeit at a lower rate of one percent.

Amid the furor over the wealth tax, many of the earmarked taxes were passed, and the overall rates of sales taxes and income taxes increased. The controversy over the wealth tax distracted attention and resistance away from these more mundane -- but no less important -- developments. From a level of less than 13 percent of gross national product in 1964, tax revenues rose to 18 percent by 1967 and over 21% by 1970 (Ffrench-Davis 1973: 252, 329). New taxes, increased tax rates, and stricter enforcement of existing penalties for evasion (e.g., the first prosecutions for tax fraud in Chilean history!) more than doubled tax revenues under the Frei administration.

These changes came at some substantial cost to the coherence of the Chilean tax system. The short-lived Allende administration (1970-1973) proposed to streamline the tax system in order to eliminate loopholes that provided the opportunity for high-income taxpayers to avoid taxes. The budget and the tax package were submitted together in an effort to force the legislature to meet the financing needs of the expanded spending program. It was presumed that the onus for inadequate taxes would be laid to Congress, thus strengthening the administration's position should it call for a plebiscite. Allende's approach to tax reform was openly confrontational, a choice of little cost given the polarization that already prevailed.

The Congressional opposition reacted in the same manner as did the opposition to Belaunde in Peru during the 1964-68 period (see the discussion of Peru below). Instead of refusing to allow for higher taxes and cutting government spending accordingly, or acceding to tax increases, the legislative opposition exaggerated the spending burden without allowing for higher tax rates. The discrepancy between revenues and spending increased. By 1972, the last full year of the Allende administration, the fiscal deficit reached over 40% of central government expenditure, compared to less than ten percent during the 1967-1969 period. The deficit was financed largely through internal borrowing, which contributed greatly to domestic inflation (Cauas 1974: 133)

In 1973, with hyperinflation already underway, the Congress passed higher state-sector wage increases than the Allende administration had requested; when Allende vetoed that bill, Congress rejected his tax-increase proposals. Congress flaunted its control over taxation by passing a simplified tax structure, as the administration had proposed, but with lower burdens for high-income taxpayers. Less than half of the increased spending was covered by revenues (de Vylder 1976: 92-93, 223). By that time, the plebiscite threat was irrelevant, because the Allende administration had lost the support of middle-class voters necessary for a decisive victory. By September the Allende regime was toppled by the military.

In retrospect, it seems obvious that any sort of coherent tax reform under Allende was illusory. The Allende economic team took over without a carefully crafted economic plan, much less a well-prepared tax reform. The drastic economic fluctuations that ensued, and the implausibility that the risk of going along with a tax reform was reasonably bounded, would have undermined the technical feasibility of true reform as well as compliance to such a reform.

The 1974 Pinochet Reform

The context facing the incoming military government was, of course, drastically different. The Left was definitively crushed for the time being -- or so it appears after the fact. There was certainly a widespread belief among the victors that the Chilean entrepreneurial class had to be restored, rather than burdened further. Therefore the tax reforms under the Pinochet administration might be thought to be politically uninformative because the power of the regime was so great as to guarantee their successful implementation. Yet the 1974 reform and subsequent modifications are enlightening for what the management of risk imply about limits to reform even under those politically extreme circumstances.

In 1974, under the leadership of the newly appointed Minister of Finance Jorge Cauas, a fundamental tax reform was enacted that has remained basically in effect ever since. Although there have been adjustments, a few "dilutions" of the principle of neutrality, and much improvement in tax administration, the 1974 reform still constitutes the basic tax system in Chile.

From late 1973 through mid-1974, a technical team from the Planning Office and the Ministry of Finance addressed what they saw as the three major problems of the existing tax structure. First, Chile's chronically high inflation created many serious problems. On the one hand, tax brackets for income tax rates were rendered almost immediately obsolete by high inflation. On the other hand, delayed tax payments obviously yielded much smaller real revenues. This lack of proper means to adjust for inflation was diagnosed as a major factor in propagating inflation, as declining real revenues required the financing of the public debt through money creation (Cauas 1974: 131).

Second, there was the problem of "double taxation" of business, which in the Chilean context meant the taxation of nominal increases in capital in addition to their real profits. The multiplicity of direct taxes on income had reached a point where obvious problems with horizontal equity were encountered. It was felt that some individuals were subject to double or treble taxation. Moreover, "bracket creep" had elevated the tax burden of manual laborers excessively, according to the judgment of the Finance Ministry. Since there was a basic income tax rate, a "global complementary" add-on, and an "additional tax", all figured on different bases, individuals with the same income level could be subject to widely differing overall income taxes. The 1974 reform made the bases of these taxes coincide, in order to enhance horizontal equity, and lowered the maximum wage tax rates so that the maximum marginal tax rate would not exceed 60% (Cauas 1974: 145). Direct taxation of corporations was also seen as grossly distorted. To avoid corporate profits taxes, companies were re-investing profits in ways the government judged to be suboptimal, companies were maintaining large raw material inventories in order to avoid holding taxable liquid assets, and many forms of business assets were vulnerable to reduction through taxation of their inflationary increase in nominal terms.

Third, the technical team addressed the problem of a multiplicity of indirect taxes that added one tax on top of another to the same item without regard for the value added in each step or transaction. The technical team wanted to apply the value added tax globally

More generally, the Chilean tax code was encumbered by countless exemptions and exceptional categories that had no clear justification in terms of desirable investment incentives. In 1974 Finance Minister Cauas judged this complexity as tantamount to "complete anarchy in matters of taxation." But beyond the difficulties of tax administration per se, these exemptions created distortions in investment incentives that "seriously limited the possibility of using the tax policy as one of the most important tools in the economic and social development of the country." (Cauas 1974:122). While admitting of the possibility of desirable tax incentives, the diagnosis was that the bulk of existing exemptions were counterproductive.

<u>The Junta's Adoption of Technical Team Recommendations.</u> Whereas one might think that the Chilean situation as of 1974 was a perfect instance of the bureaucratic authoritarian fusion of the military and the technocrat, there were still considerable differences between what the tax-reform team recommended and what the Pinochet-led junta believed to be politically advisable. To be sure, the greatest accomplishment of the 1974 reform was to offset the distortions resulting from inflation, by adopting the technical team's ingenious appraoch to inflation adjustment. Yet the uniformity desired by the technical team and the Finance Ministry was only partially achieved. Some special treatments remained, although they were at least simplified and partially unified. For example, regional development laws were to be applied without discrimination in terms of the type of activity, and sectoral exemptions were to be granted without discrimination in terms of the region. All "discretionary" application of tax laws was formally eliminated. No new exemptions to

the global complementary single wage, and additional taxes were permitted, and all existing exemptions eliminated.

The sales tax was replaced in 1974 for the value-added tax (VAT or IVA). Whereas the technical team had recommended a global VAT, certain exceptions were made. Except for processed foods, sales of articles in the agricultural sector were exempted, and an excise tax remained on some luxury items including non-alcoholic beverages and (with a different rate) alcoholic beverages. On the other hand, with few exceptions services were included at the same rate as products.

A 20% value added tax is very high by international standards. But it was justified on the grounds that this had already been the level of transactions taxes that the non-evading (and apparently largely hypothetical) "honest" taxpayer would have been paying. Of course, actual evasion of the prior transaction taxes had been substantial enough to make the less evadable value-added tax a much greater effective tax burden. On the rhetorical level, the comparison with the prior "honest" level had the advantage of neutralizing the issue of whether greater actual reliance on a flat-rate direct tax would have redistributive implications.

While the value-added tax was cleverly designed to reduce evasion (for example, value added was calculated as the difference between sales and purchases, thus providing incentive for intermediate purchasers to report fully on the sales of their suppliers), there was far less effort to ensure full compliance and even horizontal equity with respect to the income tax. Marginal rates remained very high for high brackets (50% even after the 1984 reduction), making it practically mandatory for the rich to resort to tax shelters or evasion. Income earned from different sources (a common occurrence for professionals) were taxed at the marginal rate for each source of income rather than at the marginal rate for the combined income; income earned on interest, typically evaded in an open way, remained untouched despite proposals to withhold tax on it. There were some modest improvements in direct taxation (e.g., corporations were made to collect a dividend withholding tax), but the generally greater weakness of direct tax collection reduced the weight of direct taxation and, according to many critics, undermined the vertical equity of the tax structure. Income taxes soon accounted for only 4% of government revenues. (Arellano & Marfan 1987: 28-30).

Many of the 1974 Chilean reforms entailed the elimination of special treatment for groups that had received politically-motivated concessions under previous administrations. For example, individuals involved in passenger transportation and trucking, who could easily engage in economically-disruptive strikes or slow-downs, had been placed in particularly favorable tax status. That was no longer politically necessary under the Pinochet government.

It is a very interesting twist that the 1974 Chilean tax reform made very little provision for the adequate taxation of high-income landowners. The sweeping land reform of the Allende era had left the countryside nearly empty of large landowners in current possession of their former property, and the idea of trying to impose complicated tax filing procedures upon the new small-plot owners or agricultural collective members seemed counterproductive. However, the restoration of the property rights of the former large land-owners was already underway. Yet they were both allies of the new government, and still appeared to that government to be the dispossessed rather than a target of extraction. Over the years, the tax system's lack of mechanisms to tax agricultural income effectively has emerged as a major problem.

Considering the political strength of the Pinochet government and the commitment to fundamental tax reform of the Pinochet economic team, one may ask why the 1974 reform did not accomplish even more; why it did not approach the issues addressed by the 1984 reform? If in 1974 the military had enormous political dominance, and yet many thought that the opportunity for drastic reform may soon pass, why did the reform go no further?

One of the constraints faced by the 1974 Chilean economic team, given its desire to make a sweeping change in the direction identified with the "Chicago boys", was the skepticism toward such radical changes within both the government and the military. The tax specialists, even if they were convinced of the reasonableness and predictability of going all the way with such reforms as the complete elimination of the personal income tax, could not fully relieve the anxieties of the "non-Chicago boys" and the non-experts that such changes might be quite risky.

The Chilean tax experts were the first to admit that the vertical incidence of the tax system prior to the 1974 reform was very difficult to estimate, owing to the fact that two-thirds of the tax revenues were from indirect taxes on products whose consumption patterns had not been examined in terms of the income levels of consumers (Aninat 1975: 167). The lack of either fact or myth on the vertical incidence of the existing tax system made it more compelling to leave the issue of vertical distribution to the side.

There were parallel political concerns. The military itself was not monolithic in terms of its views on income distribution and the general direction of economic strategy. For example, some high-level officers were attracted to the reform not because it ultimately had the effect of reducing the weight of direct taxation, but on the contrary because they believed that it would have the effect of clamping down on high-income earners' evasion of corporate and personal income taxes. As one observer put it, "The military, after all, were salaried, and had everybody else's resentment against the flaunting of the tax system by profit-earners."[16]

In addition, the military was not oblivious to the need to cultivate some popular support. Since large segments of the population had become thoroughly disillusioned with (and antagonistic toward) the Allende administration, it was not out of the question that the military might be able to win over hearts and minds by rationalizing the revenue system so as to be able to provide a solid basis for social-service expenditures.

The 1984 Reform

Whereas the Chilean tax reform of 1974 was impelled by the disastrous state of Chilean public finance, and the need to cover public expenditures that could not be avoided in the short run, the reform of 1984 was formulated in a context of continuing efforts to diminish the role of the state in the Chilean economy. It was believed that reducing the still high marginal tax rates and corporate taxation would encourage private savings (Cheyre 1986a). The objective to stimulate savings was also presented as noncontroversially technical. Yet critics, principally those identified with the Christian Democrats and the prominent research center CIEPLAN, disputed that transferring more savings potential from the public sector to the private sector would enhance overall investment. The critics were quick to point out that there was no evidence, nor much theoretical rationale, to expect this to occur (Marfan 1987).

The 1984 reform deliberately eschewed technically complex ways of taxing spending (e.g., basing a spending tax on declared income less declared savings, or on directly declared spending) as impracticable (Cheyre 1986b: 14), although it had been part of the original proposal. Therefore the emphasis remained on making the VAT a more significant source of revenues. Yet here, too, the critics attacked the global VAT as regressive, on the grounds that lower-income individuals consume a larger proportion of their incomes. Tax specialists within the government and at the Economics Deaprtment of the University of Chile call the same phenomenon "neutral," on the grounds that eventually all income ends up in consumption. The striking aspect of this dispute is that a basically ideological difference can create disagreement on such an important, seemingly technical issue of what constitutes neutrality.

Yet the critics making a fundamental theoretical attack of the approach had only one channel for circulating this rather complex argument -- their own technical publications. In Chile, where the depth of technical capacity is quite impressive and "technopolitics" is as important as "bureaucratic politics", "opposition" experts have very little access to the policymakers. Of course, the opposition's appraisal of Pinochet's policies, whether economic policies or otherwise, has been so consistently negative that the government interprets any criticism as part of the political campaign against it.

Thus the constraints on going further with the VAT -- or even to the point of moving totally to indirect taxes (a "theoretical" preference of a considerable number of Chilean tax specialists) was a form of self restraint rather than manifest political opposition. In the discussions over the 1984 Chilean tax reform, the concern of the private business sector to manage its risk took on an even more exotic form. Some businessmen objected to the elimination of the corporate tax because its disappearance would leave open the <u>future</u> danger that a new government might turn on the corporate sector with higher, even punitive taxes rationalized on the grounds that the business sector had been unfairly favored by having to pay nothing before that.[17] It was felt that a safer course was to live with a moderate corporate tax, moderated even more by legal exemptions (which could in part or in whole be passed onto the consumer in any event), than to risk the possibility of future reprisals.

The same attitude holds in many quarters among high-income individuals with respect to the possibility of eliminating the personal income tax. Although some tax theorists believe that the system would have much more coherence if the value-added tax were virtually the sole source of internal taxation, there is the counter-argument, based on political judgment, that this would make high-income earners more vulnerable to future attack -- even assuming that the total elimination of the personal income tax were politically possible.

It might seem that these fears do not coincide with the observed indifference to tax issues of the pressure groups representing lower-income individuals. Yet it is widely believed that there would be a threshold effect that would be triggered if the tax system were made so obviously and wholly based on indirect taxation, without high apparent marginal income tax rates to impart the impression of progressivity.

Lessons of the Chilean Reforms

The key lesson in Chile's experiences with tax reform has been the avoidance of direct confrontation over redistribution by the successful tax reform initiators even when they seemed to hold dominant political power. As in the Colombian case, low-income taxpayer groups do not become mobilized unless tax changes are blatantly regressive. Yet the anticipation that this mobilization could occur was an inhibiting factor even for the Pinochet government. The tempting simplification of assuming that a rightist government would willingly adopt the most pro-business tax structure that its political power would permit is simply not borne out by the Chilean case.

Another lesson of the Chilean reforms is that improved tax administration changes the politics of tax reform dramatically by limiting the capacity of evasion to limit the impact of changes in tax burden. According to one Chilean economist, "The incredible strength now of the tax administration is a political danger for the government, because what the tax law says is what will happen. So the government has to build in explicitly the loopholes that are politically required. Otherwise their allies in the business sector could be seriously hurt."[18]

Finally, the debate over the Chilean tax system reveals that there is no "technical consensus" even on the fundamental definition of vertical neutrality. The separation between the overtly value-laden formulation of tax reform by political leaders, and the "technical" work that also drives the explorations of tax reform options, is blurry indeed.

B3. PERU

It is safe to say that there has been no fundamental tax reform in Peru in the last three decades. This is certainly not because of a lack of need for tax reform, and economic policy reform in general. The paradox is that tax change is often fundamentally important for the long-term health of the economy and yet a secondary issue in circumstances of instability and generally bad economic policy. When government spending is out of control, foreign reserves are dwindling, and other economic catastrophes threaten, tax reform typically gets little attention, even if inadequate tax policies are partly to blame for the negative state of affairs.

The inadequacy of the Peruvian tax system is manifested in several ways. There is unanimity of opinion that the base for direct taxes is too narrow: less than half a million Peruvians, in a country of nearly 20 million, pay personal income taxes. This is not a case of the failure (or the unwillingness) to extract direct taxes from individuals lower down in the income distribution, but rather a failure to collect taxes from many individuals with incomes in the same range as those who pay taxes.

Second, the complexity of the tax system, with modifications piled upon previous modifications, is extreme. Tax lawyers who in other circumstances would be expected to brag about their mastery of the tax system openly admit that they cannot fully understand the Peruvian tax laws.

Third, the tax system is simply incapable of generating the level of revenues that Peruvian governments have wished to extract. While export booms now and then reduced the gaps between revenues and government spending, budget deficits have been a chronic source of economic instability, leading governments to face politically costly or economically counter-productive options. This is clear from the Garcia government's recent resort to forcing private corporations to purchase government bonds, coming at a time when the government is supposedly firmly committed to stimulating investment to match the demand stimulated by monetary expansion. More generally, the inability to fine-tune the level of revenues is continually apparent in the frequent reports that the government's tax changes have resulted in unanticipated declines in tax revenues.

If we begin our analysis with the Belaunde administration of 1963-68, we see a recurrent pattern of initial preoccupation with economic stimulation, with low priority given to the overall coherence of the tax structure, followed by a fiscal crisis (often tied to exogenous shocks) culminating in ad hoc adjustments even if it could have been mitigated by a prior fundamental reform.

Between the revenue-increasing options of expanding the tax base through aggregate growth or increasing the tax rates on the existing base, Belaunde's initial policies strongly favored the former. The industrial promotion policies of previous governments were expanded. Tax changes to encourage industrial investment, rather than to raise revenues, became the focus of fiscal legislation. Without definitive economic criteria for deciding which industries really warranted preferential treatment, and motivated to avoid antagonizing any business groups, the Belaunde government granted exemptions on virtually an ad hoc basis (Kuczynski 1977:80-85). To reduce the declines in revenues, the government raised import tariffs (sold politically as part of the campaign to promote domestic industry) and sales taxes (Webb 1977:51-52), but without placing these measures within a broad reform. The sales tax increases were very costly politically, because of the prevailing (but disputable (Webb 1977: 50-53) belief that indirect taxation is inherently regressive.

As the need to raise revenues mounted, the Belaunde administration pressed Congress for increases in direct taxes but in fact settled for further increases in import duties. Since the rules allowed for "administrative updating" of import categories, changes in import duty rates were barely visible and did not require Congressional approval.

The epitome of government futility came in 1966, when the Belaunde administration's Finance Minister Sandro Mariategui finally submitted a significant tax reform embedded in the 1967 budget, calling for higher income taxes and new taxes on real estate and enterprise capital shares. APRA leader Haya de la Torre mobilized his supporters with the slogan, "No more taxes!" Congress rejected the taxes but approved the spending package. Instead of withdrawing the bill, forcing an acute crisis, and exposing the APRA to political risk of being party to an economic paralysis, the administration accepted an outcome that made the fiscal problem even worse.

The Congressional opposition to increased direct taxation was both ironic and puzzling because the major thrusts of the tax reform were increases in income and profits taxes applicable to fewer than 40,000 individuals and firms. The personal income tax was applicable only to the top 1 percent of income earners because of the high exemption levels (Kuczynski 1977: 87). This was hardly the mass public that the APRA intended to mobilize. The public's opposition to higher taxes was due in part to its identification of further tax raises with the highly visible previous increases in the sales tax. There was little recognition that further changes would place the burden on different groups.

In 1968 the APRA opposition finally relented to tax reform. Two important aspects of the political context must be emphasized. First, if democratic government could have been preserved through the upcoming elections and transition to the next democratically elected regime, the APRA stood a very good chance of winning. Thus the resolution of chronic fiscal problems, with the Belaunde administration taking the heat, was very attractive to the APRA leadership. The tax changes would not have enough time to endear the voters to the Belaunde administration; if anything, the short-term costs could have cost the Belaunde administration some support during the election campaign. Second, the fiscal situation had become so bad that the military's confidence in the Belaunde government was fast declining. APRA realized -- too late -- that Belaunde's fiscal crisis could lead to military intervention. Until military intervention became a clear threat to the upcoming election, the opposition found greater risks either in the tax change, or in the political costs of a tax reform going through, than in the economic chaos of the fiscal crisis.

The way the opposition allowed the Belaunde administration to carry out the reform is also illuminating. Rather than reversing their opposition publicly, the APRA and UNO granted authority to the executive in June, 1968 to "take the emergency measures needed to solve the structural imbalance in public finances, to strengthen the balance of payments, and to encourage the integrated development of our economy... The measures taken under the authority of this law will be in the form of Supreme

Decrees approved by the Council of Ministers, with the obligation of advising the Congress of each measure so taken." Thus the opposition agreed to move tax policy out of the open arena of Congress, so that responsibility for the sacrifices necessitated by the reforms would not be laid to the opposition.

During the two-month period of emergency power authorization, the Ministry of Finance and Commerce under Manuel Ulloa enacted many tax reforms that would have been important if they had endured. In the much more closed arena of the ministry, in an atmosphere of crisis, Ulloa decreed higher or altogether new taxes on profits, interest income, real estate, corporate net worth, gasoline (with much steeper taxes on the higher octanes used by automobiles rather than buses), and various other items. The net effect was strongly progressive (Kuczynski 1977:230-233; Webb 1977: 53), although it was hardly a coherent streamlining of the Peruvian tax system. The imperative of coming up with revenues to reduce the deficit, exacerbated by the short time period, squeezed out efforts to rehaul the entire system for the sake of coherence.

The left-leaning Velasco military government that ousted Belaunde in 1968, and the more centrist Morales Bermudez military government that ruled from 1975 to 1980, could have pursued tax reform without any of the legislative obstructionism that seemed to doom Belaunde's efforts. Yet there is broad consensus that the Peruvian military governments of the 1970s did not succeed at tax reform (Webb 1977: ch. 4; Thorp and Bertram 1978; Ugarteche 1980); indeed, it is widely accepted that the Velasco and Morales Bermudez administrations did not push for fundamental tax reform despite the relatively easy political path for enacting one. (Thorp 1983: 49; Fitzgerald 1983: 77-79).

The Velasco administration announced a basic tax reform in its 1971-75 National Development Plan, that would have entailed a very significant increase in the direct tax burden from 19 percent to 22 percent of GDP by 1975, but never carried out the reform. (FitzGerald 1983:78) The Morales Bermudez administration did not even get that far; the 1975-80 period was marked by myriad piecemeal tax adjustments that did not amount to more than trying to maintain the level of revenues in the face of fluctuating export prices. Thus in 1977 the Morales Bermudez government accepted the International Monetary Fund's insistence to reduce the budget deficit by cutting public spending, especially in cutting back on the operations of the state oil enterprise Petroperu. Whether or not the IMF's focus on budget cutbacks rather than revenue expansion was simply a case of bowing to the reality that tax reform was not in the offing, the result was that compliance was pursued through expenditure contraction rather than by confronting the tax issue.

The failure of these military governments to enact tax reform allows us to look beyond the legislative obstruction to explain why, if tax reform is so essential for Peru, so few efforts at fundamental reform been launched, let alone accomplished. The neglect of tax reform by Peruvian regimes unencumbered by legislative opposition implies a second answer: the severe imbalances of the Peruvian economy heightened the government's risks in undertaking a tax reform, while these same imbalances (as well as other conditions) diminished the apparent immediacy of the need for reform as well.
On the risk side, both Velasco and Morales Bermudez viewed the support and compliance of middle-sized industrialists ("independent industry") as pivotal for maintaining economic normalcy. For Velasco, the populist rhetoric and some expropriation had supplanted or at least antagonized the large-scale industrialists ("oligarchic industry"), leaving any remaining dynamism to the up-and-coming entrepreneurs. Since the latter were moving into areas made attractive by government subsidies via tax exemptions and cheap credit, the announcement of a fundamental tax reform initiative could have jeopardized this dynamism. For Morales Bermudez, the challenge was to restore investor confidence in general, and to convince the business sector that the Velasco days were behind them. Since Velasco's style had been the sweeping gesture, Morales Bermudez' distancing of his own administration from Velasco's included opting for a thoroughly incrementalist approach to economic policy.

What minimized the perceived need to proceed with tax reform despite these risks was the combination of hopes for state-promoted industrial expansion, export growth, improved state-sector performance, and cheap foreign capital. There was an expectation in the early 1970s that both industrial production and export earnings would rise enough to meet revenue-need projections (FitzGerald 1983:78). Under Velasco, companies taken into the "social property" sector were expected to add to savings rather than constitute a drain on savings. Under Morales Bermudez, there was optimism that the drain that did occur under Velasco could be reversed through greater discipline. To fill any investment gaps, foreign capital was available at very low real interest rates.

Nor was tax reform seen by the military governments as a necessary condition for effecting the improvements in income distribution that both Velasco and (though to a lesser extent) Morales Bermudez promised. During the military governments lasting from 1968 to 1980, the principal means of redistribution in Peru was the direct subsidy. Once the land reform had been largely completed, the governments of Velasco and Morales Bermudez relied heavily on low gasoline prices, low health-care prices, and so on, to bolster the purchasing power of the poor -- at least the urban poor. Thus there seemed to be little concern over tax reform, despite the fact that the tax system was increasingly riddled with inconsistencies. Thus in January 1980 the National Congress of Manufacturing Industries was still calling for "the integral revision of the tax system." (Centro de Estudios y Promocion del Desarrollo 1982: 3781)

Thus when Belaunde took over again in the 1980 restoration of civilian government, his highly-trained, anti-statist economic team took several steps to liberalize the economy. State investment in productive sectors was redirected from competition with the private sector to infrastructure in support of private sector initiatives. To launch these huge infrastructure projects, Belaunde's economic team still looked to foreign borrowing rather than fundamental improvements in revenue collection -- a choice made possible by the fact that the Morales Bermudez austerity program had reduced inflation, improved the external trade balance, and balanced the budget. The creditworthiness accorded to Peru at the beginning of the Belaunde term, and momentarily high export prices, once again seemed to vitiate the need for tax reform. By the time the explosion in real interest rates reduced the viability of additional foreign borrowing in the early 1980s, the Belaunde administration was battling the recessionary effects of another downturn in export prices, while trying to hang onto the large public works projects that Belaunde claimed as his hallmark. Thus, while a tax overhaul in the name of supporting these large projects may have gained some political support, the need to counteract the recession put tax reform off the agenda.

What was done with respect to tax changes was characteristically hemmed in by other considerations far removed from rationalizing the tax structure. For example, the Belaunde team saw the elimination of market-distorting subsidies as an important aspect of economic reform. This was thought to hold a political risk, inasmuch as urban disruption in reaction against the withdrawal of such subsidies might be expected. The Belaunde government hit upon a way of softening the blow of eliminating the subsidy on gasoline, by tying it into changes in the tax structure. With much fanfare, the increases in gasoline prices were announced as part of the effort to increase the profits of Petroperu, which then would be more heavily taxed to underwrite general government expenditures.

The very heavy reliance on the taxation of Petroperu that emerged was the politically easy way out for the Belaunde government. It was certainly a narrower political battle to fight than taking on a private-sector group, or trying to make painful (and uncertain) changes in tax administration. The "bureaucratic politics" confrontation between Petroperu and the central administration was the only hurdle, and Belaunde could choose the Petroperu head. Petroperu had never made the fortunes that could make it a power unto itself like Mexico's PEMEX. The very fact that "taxing" Petroperu was discussed in the same vein as taxing the private sector was a bit disingenuous, since Petroperu's profits were the state's.[19]

The Aprista administration of President Alan Garcia was elected in 1985, following a horrendous economic contraction; austerity measures and drops in copper and oil prices left industry running at 40% of installed capacity. Whereas several aspects of economic imbalance were sure to continue (such as inflation exceeding 200% in 1985), the opportunity to revive the economy was far more attractive -- politically as well as economically -- than confronting a tax reform that would create uncertainty for all concerned in direct proportion to its depth. Here again, the initial conditions of economic contraction could be traced back to poor revenue collection and the budget deficits that brought about an austerity program as the policy response, but the immediate reaction was to re-stimulate the economy -- hardly what a thorough and deliberate tax reform would encourage -- in order to take advantage of the untapped potential for economic expansion.

The Garcia administration, as part of its anti-inflation program, has artificially kept down the price of gasoline, among other basic consumption goods, thus eliminating the possibility of relying so heavily on the taxation of Petroperu. Yet coming to grips with the inadequacy of the tax structure seems to remain a low priority for the Peruvian administration.

Carol Wise (1986:5) points out that "the last three austerity programs (in 1967-68, 1977-78 and 1983-84) signified a final deathblow for the government that implemented each. Usually, it has been the succeeding government that has enjoyed the economic benefits, in terms of a greater financial flexibility; nevertheless, the final results of this additional 'margin of maneuver' have not been particularly favorable." It seems that one very unfortunate result of the sacrifices made by Peruvian administration in the last gasps of their tenure is that their successors see little immediate need for fundamental tax reform and considerable costs to undertaking such a reform. In these acute stop-go cycles, fundamental tax reform seems to be the last thing on the minds of top policymakers trying to cope with deterioration or taking advantage of expansionary opportunities. Moreover, as long as government economic policymakers believe that the rather heavy-handed policy tools of direct subsidies to consumers and manufacturers, augmented by price controls, will solve the distributional issue and increase the revenue base, the logic of fundamental tax reform will hardly seem compelling.

The Peruvian case also shows quite clearly that formal authority to make tax changes, which appears so important in Colombia because of the complicated circumventions that tax reforms had to employ in order to overcome congressional opposition, is not only insufficient to ensure constructive reform, it can even be counter-productive. Peruvian law permits the President to adjust even tax rates <u>during</u> the fiscal year, without legislative approval. This obviously creates considerable uncertainty for business planning and investment, inasmuch as the after-tax rate of return of a given investment remains uncertain even if the business side of the investment is well understood.

C. Some General Lessons

The experiences of the three countries examined above, and the importance of risk and its management, yield several lessons for each phase of tax-reform policymaking.

With regard to <u>initiation</u>, uncertainty of success is often a serious inhibition against the investment of significant effort by private groups, even if certain private groups may ultimately benefit greatly from tax reform. For reasons of complexity and the apparent indirectness of impact, organized labor exerts little effort over tax issues, unless there is a clear danger (as opposed to opportunity).

One implication of the typically defensive stance of interest groups vis-a-vis tax reform is that tax reform, whether to increase revenues or to improve distribution, tends to be an initiative of the state. There are instances of private groups petitioning for more favorable tax treatment and for a roll-back in what they argue are excessive rates, and there are cases of private sector initiatives to reduce the red tape and distortions of particular tax regulations. Yet these are relatively rare and modest efforts, because they too have the potential to open up an unpredictable chain of events. In short, without the government as the prime mover behind fundamental tax reform, it would be a very quiet field.[20]

Another implication is that the potentially redistributive nature of tax changes, combined with the uncertainty inherent in any new taxation, makes <u>risk avoidance</u> a very high priority for the typical interest group. Of course, change and innovation necessary to improve tax systems necessarily entail some uncertainty and risk for all taxpayers. The key to understanding the politics of tax reform is to appreciate the uncertainty of the impact of even moderate tax changes that persists during and even after the formulation and implementation of the reform. The frequently negative "reflex" reaction to a new tax reform initiative on the part of many groups is typically due not just to expected losses but also to the risk of incurring costs that cannot be anticipated.

Hence, much of the "artistry" of designing and negotiating tax reforms is in introducing innovations that nonetheless involve a tolerable degree of risk for politically and economically powerful interests.

State initiatives may be motivated by the obvious consideration that more efficient tax collection increases the power of the state. In some cases, tax reform can even become an issue of positive political payoff for the administration. This temptation can go too far, as too many tax changes to cash in on the political appeal of tax reform activism can be inefficient if tax administration cannot settle down to administering the same set of tax regulations.

In other cases, a seemingly ripe moment for tax reform can be squandered because more serious economic policy problems distract from concern over tax reform. Even if the government favors tax reform "in theory," serious economic disequilibria drive out initiatives for fundamental tax reform.

In electorally competitive systems, "ripe" moments for introducing tax reform are:

a. the beginning of an administration, if the electoral margin was large, and the solid prior studies exist

b. a financial crisis prevails, if the government maintains both credibility and good macro-policy.

c. the political opposition, if not in principle opposed, foresees winning the next election and hence prefers the current administration to bear the costs of imposing a painful reform.

The promotional appeal of some tax reforms rests heavily on the attractiveness of horizontal equity. Striving for horizontal equity (except between sectors) is the consensus point for tax reform because it seems ethically compelling, technically straightforward, and does not raise the issue of class conflict. Vertical redistribution can sometimes be achieved as a consequence of measures explicitly designed to promote horizontal equity.

However, the issue of horizontal equity is often a sectoral issue, especially on the dimension of industry vs. agriculture. The politics of "sectoral clashes" is quite distinctive from class politics. By bringing in the debate over development strategies, sectoral champions can argue in favor of (cross-sectoral) horizontal inequality (e.g., by arguing that overall growth would be enhanced by providing more investment and income in one sector rather than another).

Although tax changes may be understood in terms of their impacts on income classes, interest group structures simply are not organized in terms of income classes. Typically they are organized "functionally" within industries and, as they aggregate through umbrella organization, within functional sectors such as manufacturing, agriculture, banking, mining, etc. Thus much of the politics over economic policy is structured around "sectoral conflicts".

Sectoral politics may be accentuated by social and political cleavages among the sectors (e.g., the "landed oligarchy" vs. the "nouveau riche industrialists), but it is also fundamentally embedded in interest group organization. Even if individuals and families mix their investments among different sectors, their organizational spokesman are still expected to lobby only for the interests of the particular sector or industry formally represented by that organization. Thus, no matter whether the Peruvian fishmeal processing is capitalized by landowners or industrialists, the fishmeal processors' association by and large pursues policies perceived as beneficial to the fishmeal industry and its profitability.

A final point on the definition of the tax reform issue is its linkage with other potentially redistributive initiatives. Economic groups react to the risks of a given prospect of policy change in the context of other risks. Thus a key factor in securing the acquiescence of economic groups facing risks from tax reform, beyond clarifying the limits of tax reform per se, is to tie the tax reform to guarantees that other risk-laden policy changes will be held in abeyance.

It may seem that fundamental tax reform -- even if it is defined modestly as reform that has long-lasting impact -- requires careful cultivation and therefore is incompatible with such short-term reactions to emergency situations as stabilization programs. Yet the prod of emergency is a resource of great potential importance for overcoming or discrediting opposition. Furthermore, it is often of great advantage to implement economic reforms at the very outset of a new administration's term, not only to take advantage of the political clout of a president with a full term left to punish recalcitrant opposition, but also to catch the opposition unprepared. It is therefore significant that several tax reforms were successfully imposed as part of emergency stabilization programs or as "lightening bolts" of a new government. How can this be done effectively?

If the key to effective reform through immediate or emergency action is careful prior contingency planning, then either the existence of an established cohesive technical team is essential, or the government must accept a blueprint of a preceding regime or earlier external mission. The Colombian reform benefited from the former, while the Peruvian military regime the came to power in 1968 essentially capitalized on initiatives of the preceding civilian regime of Fernando Belaunde. If the current government does not share the objectives of previous administrations, and lacks the resource of a previously established technical team, then its chances of being ready with a viable tax reform are much reduced.

Yet in the estimation (or technical design) phase of tax-reform policymaking, it is unlikely that there will be consensus among experts. Not even the concept of "vertical neutrality" is consensually accepted by technical specialists. The chronic problems of tax evasion and avoidance (see implementation below) encourage innovativeness of tax design -- which also feeds the professionalist aspirations of the tax reform specialists. Yet evasion-minimizing forms of taxation often add to complexity; and complexity adds to uncertainty. Complexity facilitates evasion and avoidance. Those tax changes that are designed to effect greater redistribution by cutting off all avenues of escape for the high-income tax-payer to avoid or evade tend to increase complexity, with the obvious but ironic effect of creating new opportunities for evasion and avoidance, as well as jeopardizing political consensus.

The tax specialist may be asked to "design in" several objectives for the tax reform. However, too many objectives can undermine basic purposes, inasmuch as complexity, whether for the sake of accomplishing multiple goals or not, increases uncertainty and hence risk. Experienced policymakers and technical specialists recognize this fact, and often design the bulk of the real tax change to be borne by existing taxes.

The involvement of foreign tax missions in the technical work of a tax reform can have positive or negative effects on its feasibility. A strong technical reputation must be clear to the actors most concerned about the tax reform, lest the foreign mission be seen as yea-sayers for the government. Foreign tax missions have contributed most by preparing domestic experts, and background analyses, to be available when the domestic political and economic conditions are ripe for the reform.

With respect to selection (i.e., the authoritative choice of tax policy), no government can afford to be oblivious to opposition. Such groups' perception of specific burden incidence depends on many factors beyond the actual incidence. These factors include the perception of overall "environmental" threat; thus narrower policy differences among economic groups and political movements can be an important advantage insofar as a narrower range of possible outcomes increases certainty. While a government may not be able to do anything about that range, its breadth or narrowness may help to account for the success or failure of tax reform. But the perception of future burden is also influenced by factors over which the government does have some control, such as the perception of governmental competence to design and carry out a reform as specified in the formulation stage, and the perception of evasion by various groups.

The actual burden depends to a large degree on final details. This is a major reason why support for tax reform during the formulation phase is so thin. The reduction of risk to potential opposition -- a crucial requirement for successful selection -- can be accomplished either by constraining the risk of the tax reform itself or linking it with constraints on "greater evils" (e.g., land reform from the perspective of large-scale land owners).

Even the seemingly most technical tax reforms will have political and ideological overtones. This is a direct result of both the indeterminacy of what "equity" means and the fact that any significant reform willhave distributional implications.

With respect to implementation (i.e., tax administration), success and failure both have rather counter-intuitive implications. Although weak tax administration propels the search for innovative taxes, weak administration limits which innovations are truly feasible. Although much of the attention and furor over major tax overhauls focus on novel taxes, the changes in tax incidence typically come from existing taxes applied at different rates.

From a static perspective, the distributive liability of weak tax administration is that it generates pressure to tax the most easily taxed. However, from a dynamic perspective, weak tax administration, in reducing risk, gives greater range for reform of formal tax regulations, where political opposition could otherwise be fatal.

Efforts to strengthen a weak tax administration pose political issues, because: a) stiffer anti-corruption rules may be interpreted as an attack on the bureuacrats as a group; and b) the insertion of new personnel may be interpreted as "infiltration" by whatever ideological line is attributed to the initiators. However, it is difficult to oppose a strengthening of tax administration if it is carried out in the name of horizontal equity.

With respect to appraisal (i.e., evaluating the quality and success of the tax reform and the tactics used to pursue it), the first lesson is that success must be gauged relative to the political resources of the initiators. Thus the Colombian reform of 1974, while certainly impressive, must be evaluated in light of the tremendous clout of the Lopez Michelson administration.

A similar lesson of comprehensiveness of evaluation is that equity is most usefully considered in terms of overall fiscal policy. For example, a tax change that reduces progressivity may nonetheless increase revenues to such a degree that the lower-income groups are better off in net terms.

In terms of how the actors themselves appraise tax reform initiatives, it is clear that no tax reform will get universally high marks. There is always a different sort of sweeping reform that could be proposed as an alternative -- to distribute differently, to promote investment rather than just savings, etc. Since the appraisal will necesarily depend at least partially on formal incidence rates rather than actual incidence, and on impressionistic evidence, there will always be disagreement.

With respect to termination (i.e., ending or changing a tax reform), we find that: a) because incidence is a matter of late-settled details, the technical estimation at the outset is invariably somewhat in error, or at best somewhat irrelevant; b) reform of a very messy tax system inevitably fails to address some problems; and c) even well-designed reforms deteriorate in effectiveness as target groups learn how to avoid or evade their burdens. Therefore, tax reform is never a once-and-for-all phenomenon. Weaknesses in tax policy leave open the opportunity for counter-reforms.

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Endnotes

1. A political analysis is also distinctive in its focus on the question of why policy initiatives succeed or fail, without necessarily making a judgment on the economic advisability of the reform. Lacking any reason to believe that "intrinsically good" policies face a different politics than other policy initiatives, the examination of all initiatives adds to our understanding of how politics affects the fate of reforms. And clearly, we do not want to eliminate from consideration those many cases for which expert opinion is mixed about their technical quality. Thus, initiatives of various objectives and approaches are considered, without pre-judging their advisability. And, for this analysis, a "successful tax reform initiative" means that a large part of the initiator's objectives were achieved, at rather low costs, rather than a demonstrable improvement in the tax system.

This focus requires us to concentrate predominantly on "serious" efforts at major tax changes. Knowing when a tax reform effort is truly serious -- i.e., when the initiators have great enough commitment to be willing to expose themselves to costs and risks -- is not always straightforward. After all, in the rhetoric of policy, leaders rarely say that any initiative is less than serious. Yet the effort to identify serious efforts is important, because the inquiry into the requirements of successful tax reform can be seriously misled by mixing serious initiatives with efforts understood by the actors involved to be windowdressing.

2. The success of tax reform depends, of course, on its objectives. These can be classified as universal, typical, and particular.

On the level of universal objectives, a tax reform initiative succeeds to the degree that the tax structure
. comes closer to imposing the distribution of tax incidence on activities, individuals, and firms desired by the initiators;
. more easily permits adjustments in the volume of revenues and the distribution of incidence desired by top-level economic policymakers to adapt to changing macroeconomic conditions
. minimizes the costs (foregone revenue or suboptimal distribution of incidence) required to achieve non-revenue ends.

Typically, tax reformers, especially in developing countries, also want:
. enhancement of horizontal equity; i.e., to treat all activities and individuals of a given income or wealth equally, unless there is a particular reason to deviate from horizontal equity.

. simplification of tax administration, so as to reduce administrative costs, taxpayer resentment, evasion and unwanted avoidance.

Particular objectives of some tax reform initiatives include:
. greater progressivity (or regressivity) in tax incidence
. greater (or lesser) stimulus of economic activity (e.g., savings, investment, consumption, importation, exportation)
increased (or decreased) tax revenues.

3. Particularly in Chile. See the account of tax reform sequences below.

4. With the exception of one episode in the mid-1960s, the Colombian labor movement is virtually absent from the accounts on debates over tax reform. Miguel Urrutia goes so far as to bemoan the fact that such groups cannot be mobilized on the tax reform issue (See the section on Colombia). In Peru and Chile, the independent involvement of the labor movement, apart from its participation in partisan movements, has also been very low as judged by the absence of prominent actions or pronouncements.

5. This reform and others in Colombia are described in Perry and Cardenas 1986.

6. A presumptive income tax requires a property holder to pay a minimum income tax based on calculations of how much income would be generated by a property of given value. Obviously, the yield ratio and the property valuation are critical to whether such a tax is high or low.

7. "Legitimate" here is used to mean "accepted as normatively appropriate". Invoking emergency powers was regarded as a constitutional step, even though it was still up to the Supreme Court to decide whether the justification was adequate and the measures in keeping ith the constitutional limitations of its use.

8. The events are covered extensively in both Urrutia 1983, Ch. and Perry & Cardenas 1986. Both Urrutia and Perry were key members of the technical group.

9. Inflationary increases in asset values were thus taxable. The advocates of this policy believed that it would create pressure against inflation, while its opponents protested that it was confiscatory of accumulated wealth. (Urrutia 1985: 36) The latter may also have been an intention of the more radical members of the technical group.

10. At the time, the President was expected to choose opposition cabinet members in rough proportion to the electoral split. See Dix 1986 for a description of these arrangements.

11. Interviews, Bogota, May 12, 1987: nos. 3,4,5,6

12. Compare this with the lower-middle class APRA objections to tax increases in Peru in the mid-1960s.

13. Urrutia, 34; interview with Ivan Obregon, 5-14-87

14. There are three kinds of costs. First, the government may sacrifice other policy gains in order to gain sufficient support for the tax reform. Second, the government may use up some of its "political capital" in accomplishing the tax reform, thereby leaving it with less power to accomplish other objectives. Third, the tax reform may lead to adverse economic reactions by non-governmental actors.

15. Detailed descriptions of these episodes can be found in Molina 1972; Ffrench-Davis 1973; Sigmund 1977; Ascher 1984.

16. Interview Chile-11, Santiago, Chile, April 26, 1987.

17. Interview Chile-8, April 26, 1987, Santiago, Chile.

18. Interview Chile-10, Santiago, Chile, April 27, 1987.

19. The taxation of Petroperu was not entirely "show", though, because it was tied to the elevation of gasoline prices.

20. One could argue that all groups calling for greater governmental spending are essentially pressing for tax changes insofar as expenditures create pressure for greater revenues. Yet pressure for greater spending does not address several central tax reform issues: the form of taxation, its efficiency or its equity. Moreover, the lobbying for greater spending typically does not engage the negotiations over tax policy. For better or for worse, they are largely separately interchanges.