Managing Tax Reform

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Contents

1. INTRODUCTION

Designing an appropriate and workable tax reform is not an easy task in any country. To have such a reform accepted and then successfully implemented is much more difficult. Managing the whole process of tax reform from inception to conclusion is far from simple, not least because of the inherently political nature of any significant tax reform. There is no simple, magic answer to the many complexities facing those who undertake this task. Each country, and indeed each major reform, will, and must, take its own particular path.

Any major tax reform is unique in the sense that it takes place in the unique circumstances of that place at that time.[1] Nonetheless, much may be learned from experience with somewhat similar exercises in somewhat related circumstances. A comparative approach to public policy may, for example, provide a useful corrective to the apparent belief of many that there must be a simple solution to be found somewhere else in the world that can replace the seemingly unending problems and process of negotiation that characterize tax reform in their own country. Alas, there is no such reformer's paradise to be found anywhere. Fortunately, however, much can be learned from studying how different countries have coped with tax reform. Although the solutions reached may be different, the basic problems faced are often similar. The comparative approach cannot offer a clear prescription as to precisely what should be done at any particular time in any particular country. Nonetheless, considering carefully how different countries have dealt with similar problems and trying to uncover the principal factors that appear to have determined both what has been done and how successful it has been can be an illuminating exercise.

The main aim of this article is to present a condensed version of some of the complex facts surrounding several major tax reforms in developing countries so that those concerned with such matters elsewhere may learn and profit from both the successes – transitory though they may sometimes be – and the failures of others. This task is undertaken in the third part of this article. By way of background, however, the second part of the article first discusses briefly several different perspectives on the tax reform process that may help us to understand both the critical elements of the process and the different ways in which it may be approached. The final (fourth) main part of the article reviews some lessons that earlier writers have derived from consideration of such experiences and suggests some possibly useful rules for would-be tax "reformmongers" – as Albert Hirschman once called those in the difficult business of trying to bring about policy change in developing countries.[2] The fifth part concludes.

2. APPROACHES TO TAX REFORM

In a recent paper, Lledo, Schneider and Moore set out a useful categorization of some of the many approaches to tax reform found in the literature.[3] The four approaches they distinguish may be somewhat cavalierly categorized as follows:

(a) *The public economics approach*. Found in any public economics text,[4] the focus of this approach, in essence, is on setting up a tax system that (in the purest version of the approach) maximizes social welfare, balancing efficiency and equity in accordance with society's (assumed) objectives. Although this strongly normative approach dominates the economic literature, it has not had any greatly marked influence to date in the real world of tax reform. This approach usually stresses neutrality as the immediate objective of policy reform.

1. This article focuses on major tax reforms. Many countries are constantly "reforming" their tax system by altering rates, redefining bases, and adding and clarifying interpretations to existing law, and it is not always a simple matter to tell when such "technical changes" constitute a major reform. For the most part, however, this question is left out of account here.
2. Hirschman, Albert O., *Journeys Toward Progress: Studies of Economic Policymaking in Latin America* (New York: Twentieth Century Fund, 1963).
3. Lledo, Victor, Aaron Schneider and Mick Moore, "Pro-poor Tax Reform in Latin America: A Critical Survey and Policy Recommendations", Institute of Development Studies, University of Sussex, March 2003.
4. With special reference to developing countries, see Newbery, David and Nicholas Stern (eds.), *The Theory of Taxation for Developing Countries* (New York: Published for the World Bank by Oxford University Press, 1987); and Ahmad, Ehtisham and Nicholas Stern, *The Theory and Practice of Tax Reform in Developing Countries* (Cambridge: Cambridge University Press, 1991).

(b) *The macroeconomic approach.* Although perhaps not the best label for it, the macroeconomic approach is also common ground among economists, especially those not specializing in public economics. This approach focuses less on the internal structure of the tax system and more on the impact of taxes on real aggregates, such as the growth rate and the level and distribution of income and wealth. Though hampered by the lack of much solid evidence in developing countries, beliefs about such matters (though seldom burdened by much consideration of either administrative or political concerns) have at times carried considerable weight in tax policy debates. This approach usually stresses the role of taxation in promoting economic growth.

(c) *The administrative approach.* As this author has discussed at length elsewhere,[5] this approach emphasizes the interplay between what *can* be done and what *should* be done. Successful reforms, this approach emphasizes, invariably pay close attention to the administrative dimension, although they are not necessarily constrained by perceptions of existing administrative capacity. This approach often stresses simplicity.

(d) *The political approach.* This approach recognizes both that there is no such thing as the "benevolent dictator" implicitly assumed in the public economics approach and that taxation always reflects the clash and interplay of interests (and ideas) within an evolving institutional context. Some who take this approach see taxation as an integral part of the social contract – essentially a quite different normative approach (often called "fiscal exchange") in which we, the people, agree (usually implicitly) to be taxed in such and such a way provided that you, the government, simultaneously agree to provide such and such a set of services. Others stress instead the role of taxation and especially tax reform as an exercise in political legitimacy, or as an instrument and indicator of state institutional capacity, or as an integral part of the democratization process. This approach often stresses especially the need for both equity (considering both sides of the budget) and transparency and accountability.

An interesting comparison of one (loosely) "political" approach to tax reform – the fiscal exchange approach associated with Buchanan – with both the now dominant "optimal" public economics approach and the equally normative older "equitable" tax approach (associated with such scholars as Musgrave and Shoup) that shaped much of the work on tax reform before e.g. the late 1980s was made some years ago by Hettich and Winer.[6] Without going into the details of their argument, for present purposes it suffices to note that they concluded that all three of these attempts at developing a normative approach to tax reform are seriously deficient in several important respects. Specifically, they suggested that none of the three theoretical approaches they considered:

– offers any philosophically satisfactory way to quantify value judgements;
– offers any satisfactorily explicit way to treat trade-offs between major objectives;[7]
– is grounded in a well-developed public choice analysis;[8]
– deals satisfactorily with the complementary role of the private sector; or
– deals satisfactorily with the problem of "partial" tax reform, as opposed to "ideal" reform.[9]

One need not agree with all these arguments to share Hettich's and Winer's generally sceptical conclusion that, since none of these approaches satisfactorily factors in either administrative or political considerations, none is likely to offer much useful advice to governments that are attempting to reform real tax systems in real countries in real time.

2.1. The process of tax reform

If theory seems to have disappointingly little to offer to those charged with instituting and implementing sustainable tax reform, where else can we look? Another approach is to begin by noting that the process of tax reform may, at one level, be thought of as being divided into three distinct stages. First, policies are *formulated*, then they are *authorized* legally, and finally they are *implemented*. Each of these stages may, of course, in principle be treated in more detail, but since the administrative dimension of tax reform was recently considered in detail in another paper by this author,[10] it is not further discussed here.

Although the formal process of legal authorization – the critical legislative or parliamentary process by which proposed reforms actually become law – has been less examined than implementation, relatively little is said about it here either, other than the following few general remarks.

First, in some countries, the legislative process is not really independent of the policy formulation process. There can be very different reasons for this lack of independence. In many instances, as in most non-democratic states, the reason may simply be that the legislature has no real independence from the executive. In other cases, however, as in a "Westminster" parliamentary system with a strong party system and a majority government, although there may be vigorous public debates on tax matters, in the end, there is again no real freedom of legislative action.[11]

5. Bird, Richard M., "The Administrative Dimension of Tax Reform", paper prepared for the World Bank workshop on Practical Issues of Tax Policy in Developing Countries, Washington, D.C., 28 April to 1 May 2003.
6. Hettich, Walter and Stanley Winer, "Blueprints and Pathways: The Shifting Foundations of Tax Reform", 38 *National Tax Journal* 423-446 (December 1985).
7. The "optimal tax reform" tradition pretends to do these things, but it appears to convince only those who are already convinced.
8. Subsequently, however, Hettich and Winer themselves provided many of the elements of such an analysis; see Hettich, Walter and Stanley L. Winer, *Democratic Choice and Taxation* (Cambridge: Cambridge University Press, 1999). See also Breton, Alber, *Competitive Governments* (Cambridge: Cambridge University Press, 1996).
9. A major contribution in Ahmad and Stern, supra note 4, was essentially to refocus the optimal tax discussion in this direction.
10. See Bird, supra note 5.
11. This is because in such systems revenue measures are matters of "confidence", which means that their defeat would defeat the government and, since of course the government does not want to be defeated, it will not be when it has a majority and party discipline is strong. Interestingly, in Breton, supra note 8, the author argued that in such systems the final policy outcomes may come closer to citizen preferences than in a more open "congressional" system. In Hettich and Winer, supra note 8, however, the authors cast doubt on this proposition.

In this instance, this result occurs not because of any lack of democracy but rather because of the particular way in which political institutions are structured.

Second, in other countries – for example, some stable democracies in which the electoral system customarily produces coalition governments, or federal countries in which one part of the legislature reflects regional interests – there may again be relatively little visible direct legislative input into tax reform proposals. The reason is essentially that such proposals are not brought to the legislature until the politically necessary compromises to ensure their passage have been worked out in advance between the relevant parties and/or regional governments. How much such discussion takes place "behind closed doors"[12] as opposed to in the public arena varies greatly from country to country.

Finally, in yet other countries, the legislature may be the most crucial arena within which tax reform issues are debated and decided. In some cases, as in the United States, this results from the combination of the clear separation of the executive and legislative branches and the relatively weak party system that gives individual representatives more freedom than in most countries. In others, with superficially similar institutional structures, the underlying electoral system may be biased[13] or the party system so weak that individual legislators form shifting coalitions on many issues, in some instances, perhaps reflecting simple corruption.[14] In such circumstances, rather than debating the issues in public or attempting to influence the policy formulation process in some overt way, it is often easier (and cheaper) for those who are against particular reforms simply to block them at the legislative level.

Tax reforms may thus be blocked and altered, sometimes significantly, at the legislative stage, just as they may be blocked and thwarted at the administrative stage. Serious tax reformers in any country must therefore pay close attention to both these critical aspects of the reform process. To date, however, the literature on tax reform has focused mainly on the first stage of the reform process, policy formulation, to which the discussion now turns.

2.2. Institutionalizing tax reform

One approach to policy formulation focuses on the *substance* of what should be considered. A question often considered with respect to tax reform, for example, is how comprehensive should the reform package be, as discussed further below. Another approach, however, is to focus not on *what* should be taken into account in developing a tax reform proposal, but rather on *how* the issues, whatever they are, should be approached. A particularly useful and detailed discussion of how to "institutionalize" the process of tax reform may be found in an early study by McIntyre and Oldman.[15] Although much experience has flowed under the fiscal bridge since then, the ideas set out in this study appear to need surprisingly little updating in most respects. Since this book remains the major extant discussion of the issue, it is in any case worth reviewing at some length.

To begin with, defining the "tax reform process" as encompassing both the formulation and implementation of proposals, McIntyre and Oldman argued that more careful and comprehensive attention to putting in place appropriate institutional arrangements for tax reform would both improve the quality of the reforms proposed and increase the likelihood of their adoption and successful implementation. They gave four reasons for this positive view:

(1) better planning will lead to better "packaging" that will both attract political support and undermine political opposition;
(2) changes in reform proposals for political (or other) reasons can be made more quickly, while maintaining the basic intent of the reform;
(3) incorrect but politically appealing arguments against reform can be more easily refuted if the proposals are backed up by careful studies;[16] and
(4) politicians introducing reforms will have more control of the process in terms of timing and presentation.

As McIntyre and Oldman noted, while major reforms will always, in the end, be decided essentially on political grounds, good institutional arrangements can be critical in preventing reforms from being defeated for the wrong reasons (ignorance and misinformation, for example). Moreover, better planning is needed not only for major reforms but also for improving both the design and outcome of the many "minor" changes that are continuously needed in any tax system – not least in developing and transitional countries that are chronically short of revenue and hence under continuing external and internal pressure to deal with revenue shortfalls. On the other hand, even the best institutional arrangements for studying and developing reform proposals will never be enough in themselves to bring about good policy changes in the absence of a coherent strategy, continuing support from above, and an acceptable level of administration.[17] Good policy formulation alone is never enough: however, it should always be better than its absence, or its opposite.

Although McIntyre and Oldman correctly stressed that the specific institutional arrangements appropriate for any particular country must be developed specifically for the

12. McQuaig, Linda, *Behind Closed Doors: How the Rich Won Control of Canada's Tax System* (Markham, Ontario: Penguin Books Canada, 1987).
13. As in Latin America, for example; see Snyder, Richard and David Samuels, "Devaluing the Vote in Latin America", 12 *Journal of Democracy* 146-159 (January 2001).
14. For a fascinating study of such shifting coalitions in Ukraine, see Gorbachuk, W., "Political Economy of Tax Reform in Ukraine, 1998-2001", paper prepared for the World Bank, April 2002.
15. McIntyre, Michael J. and Oliver Oldman, *Institutionalizing the Process of Tax Reform: A Comparative Analysis* (Amsterdam: International Bureau of Fiscal Documentation, 1975).
16. For a good example, see the discussion of the tax incentives in Indonesia in Gillis, Malcolm, "Comprehensive Tax Reform: The Indonesian Experience, 1981-1988", in Gillis, Malcolm (ed.), *Tax Reform in Developing Countries* (Durham, N.C.: Duke University Press, 1989).
17. For many years, the Philippines had by far the best developed and "institutionalized" tax planning process in Asia and indeed, in some respects, perhaps the developing world; see e.g. Yoingco, Angel Q., "Tax Policy Planning and Administration: The Philippine Experience", 16 *Economic Research Journal* 124-139 (December 1969); and Yoingco, Angel Q., "Tax Research: The Philippine Experience", Graduate School, Centro Escolar University, Manila, March 1976. The results in terms of good policy outcomes, however, were not much, essentially for the reasons mentioned in the text.

conditions of that country, they suggested that such arrangements, however organized, will almost invariably include a number of key components. First, in some form or other, every country needs the following institutions in place simply in order to ensure that the unending "technical" changes that characterize most tax systems constitute good tax policy:

– an organizational unit concerned specifically with drafting tax legislation. Those who have not actually tried to see a "good idea" through to reality seldom appreciate how important it is to have well-drafted laws and regulations. Without the right drafting, even good ideas do not get very far;
– another unit concerned specifically with gathering and analysing data relevant to tax matters; and
– yet another unit charged with permanent responsibility for tax reform planning, consisting of economists, lawyers and statisticians, with ready support from management and information specialists as necessary.

In small countries, all these functions might be collapsed into one small unit, but all components need to exist if policy is to be soundly developed. Depending on the circumstances, some or all of these functions might be carried out by the Ministry of Finance, the budget office, the tax administration, or a combination of these agencies. In other cases, when the legislature is relatively independent, some form of tax policy organizational structure may also be needed.

Second, although many configurations of these different components of the tax policy development function are possible, the key question is always where the "central" control lies:

(a) Should it be in the tax administration? This seems unlikely since experience suggests that combining tax policy and tax administration usually means that top management pays less attention to effective administration than it should, while at the same time tax policy initiatives may be unduly constrained by the concerns of the current administration.

(b) Should it be in the Ministry of Finance? While logical in many ways, this may mean that tax policy is developed in too much isolation from either administrative realities or developmental concerns.

(c) Should it be in the Ministry of Development (or Planning, or Economy, whatever the equivalent is called)? The problem may now be that the ideas developed are completely beyond the effective capacity of the fiscal system.

(d) What about the budget office (assuming it is different from the Ministry of Finance – for example, part of the presidential office)? Perhaps the proposals emerging from this source may then be too driven by short-term revenue needs.

(e) Might the best answer be to have a multiplicity of sources – as it were, to have a competition of reform ideas? Some might say that skilled technical resources are far too scarce in most developing countries to be thus "wasted" in duplication. Equally, however, it may be argued that good, workable reform ideas are too important to leave to a monopoly or to cut off potential alternative suppliers.

Finally, when major tax reforms are being considered, the "normal tax policy machinery" discussed above – however it may be organized and positioned in reality – usually needs to be expanded greatly. Often, this is done by naming some kind of ad hoc committee of external experts. McIntyre and Oldman argued, however, that unless such a committee is adequately staffed and supported (e.g. by the "normal" machinery set out above), it is unlikely to be able to develop good, workable reform proposals in a reasonable time. The real advantage, they suggested, of such a committee is more likely to be "... that its membership may consist of persons of high academic and political stature who can help sell the reform proposals to the legislature and the general public".[18] The emphasis in this statement on "selling" reform ideas is important and is discussed further below, as are the possible role and limitations of foreign experts in this connection.

On the whole, experience with special reform commissions, whether foreign, domestic or mixed, has not been all that great. Often, it seems, appointing an "outside" group to study a problem is simply a way to avoid having to deal with that problem, at least for a while. In other cases, by the time the commission reports, the initiating problem – usually a revenue crisis – has gone away or has necessarily been dealt with in another way; or else the commissioning government has gone, and the new brooms are not interested in old ideas.[19] For this reason, some studies of the tax reform process in countries (like Canada) which have made much use of such commissions have suggested that what is needed instead is some form of "more permanent tax review body with a trained staff and a tradition of independent investigation ...".[20]

3. TAX REFORM IN ACTION

This part presents brief case studies of tax reform in a few developing and transitional countries. No attempt is made to tell the complete story of any particular tax reform episode in any of these countries or even to give a very balanced account. The idea is simply, first, to give readers a glimpse of some of the different ways in which tax reform can be approached and, second, to highlight particular aspects of different cases that may help illuminate the more general discussion elsewhere in this article of the reform process and how it might be managed.[21] Although the substance of reform cannot be avoided, in keeping

18. McIntyre and Oldman, supra note 15, at 44.
19. For a partial counter-example, see the discussion of Colombia in 3.
20. St.-Hilaire, France and John Whalley, "Reforming Taxes: Some Problems of Implementation", in Laidler, David (ed.), *Approaches to Economic Well-Being* (Toronto: University of Toronto Press, 1985), at 221. Of course, such a structure is not enough to do the job on its own; see the case of the Philippines mentioned in note 17, supra.
21. Although the facts of these cases are taken largely from the specific sources mentioned, it should be emphasized that the interpretations are entirely this author's responsibility. For other useful studies of tax reform in particular developing countries, see Gillis (ed.), supra note 16; Urrutia, Miguel, Shinichi Ichimura and Setsuko Yukawa (eds.), *The Political Economy of Fiscal Policy* (Tokyo: United Nations University, 1989); Boskin, Michael J. and Charles E. McLure, Jr. (eds.), *World Tax Reform: Case Studies of Developed and Developing Countries* (San Francisco, Calif.: ICS Press, 1990); and Thirsk, Wayne (ed.), *Tax Reform in Developing Countries* (Washington, D.C.: World Bank, 1997).

with the thrust of this article, the main emphasis here is on the management – or lack of it – of the tax reform process.

3.1. A planned comprehensive approach: Indonesia[22]

Indonesia undertook a major tax reform in the early 1980s. This reform was unique in several ways. First, it was planned well in advance – something that is often recommended but almost never done. Second, unlike most tax reforms, the reform was not in response to a revenue crisis but rather in anticipation of a likely future revenue need arising from diminishing petroleum revenues. Third, the reform was considerably more comprehensive, both in intention and to some extent reality, than most tax reforms in developing countries. Finally, and again rather unusually, the reform was to a very large extent carried out as originally planned.

Most of the commentary on this reform concentrated on the substance of what was proposed and done, rather than on how the process was managed. Nonetheless, several points of interest emerge from this literature with respect to the way the reform was formulated and then with respect to how it was implemented. Importantly, as Gillis stressed,[23] considerable initial effort was made to identify, and focus on, those issues that were really central to effective tax reform. Some problems in tax reform are complex to understand, some are very difficult to solve, and some are very controversial politically. Some complex issues can be resolved by experts (often foreign experts) and seldom result in controversy: examples are the taxation of banks and international tax issues. The difficult issues are those where there is controversy about not only objectives but also premises, such as the eternal dispute over the efficacy of tax incentives. And, of course, every country also has its politically controversial tax issues, such as (often) the taxation of civil servants. The issues that have all three of these characteristics are what Gillis called "impasse issues", with the potential to affect many aspects of the reform if they are not satisfactorily resolved.

In the Indonesian reform, the three key "make or break" issues turned out to be, according to Gillis,[24] the appropriate role of tax incentives, the degree of rate progressivity and, more unusually, the tax treatment of interest income – a question which is central to the eternal problem of tax avoidance through arbitrage. After much study and discussion – at least within the small circle of foreign experts and government officials involved in the reform exercise – it was decided to deal with these issues as follows: (1) abolish tax incentives, (2) have some, but not much, rate progressivity, and (3) tax interest fully. The third change was almost immediately reversed by subsequent legislation. Later, even the single most striking measure in the entire reform – the removal of incentives – was weakened. Nonetheless, as Asher noted,[25] most of the policy changes made in the reform were economically desirable in principle, most of the changes turned out to be good in practice, and most have lasted. The Indonesian example thus clearly demonstrates that even a low-income country can develop and introduce a major tax reform in a relatively short time, substantially improve the tax system as a result, and sustain these good results for many years. It can be done.

But how was it done? Five aspects of the process in Indonesia may be singled out.

In the first place, and importantly, the tax reform was clearly "owned" by the Indonesians. Although considerable use was made of foreign expertise (hired and paid for by the government itself), the reform was initiated and shaped by a strong Minister of Finance in close collaboration with the planning ministry. The key group of officials involved had substantial experience and continuity before, during, and after the reform period.

Secondly, ample time (about two years) was devoted to preparing and evaluating policy options – which were, in condensed form, often presented to (and debated before) the Minister himself – and then, importantly, to drafting the necessary legislation to implement the options selected.

Thirdly, most revenue sources (except tariffs) were included in the reform, and attention was paid not only to tax structure issues but also to tax administration and compliance issues. The reform was intended to be, and largely was, unusually comprehensive in scope.

Fourthly, it was originally intended that the entire reform would be presented as a package at the same time, in the expectation that this would be politically more acceptable than a series of measures over an extended period of time. As it turned out, however, the major components of the reform – income, sales and property tax reforms – were in fact introduced at different times.

Finally, considerable investment was made both in training tax officials to run the new system and in upgrading the information component of tax administration.

In an interesting paper on tax reform in Indonesia (and some other countries), Arnold Harberger concluded that the major lessons to be learned from such experiences was simply the need "... to pound home incessantly the importance of things we knew about all along: (a) clarity of conception in designing a reform, (b) professional-level attention to detail in converting that conception into laws, regulations, and procedures, and (c) administrative machinery for implementing the reform efficiently, fairly, and above all in the long run". Such lessons, he said, were "... not exciting – more like 'how to be a good public accountant' than 'how to be a star in the movies or in the opera or on the football field'".[26]

The Indonesian reform clearly scored very well on the first two of Harberger's points – careful design and attention to detail. Despite the attention paid to the administrative

22. This section is based largely on Gillis, supra note 16; Gillis, Malcolm, "Micro- and Macroeconomics of Tax Reform: Indonesia", 19 *Journal of Development Economics* 221-254 (1985); Harberger, Arnold C., "Lessons of Tax Reform from the Experiences of Uruguay, Indonesia, and Chile", in Gillis (ed.), supra note 16; and Asher, Mukul, "Reforming the Tax System in Indonesia", in Thirsk (ed.), supra note 21.
23. Gillis, supra note 22.
24. Id.
25. Asher, supra note 22.
26. Harberger, supra note 22, at 27.

issue, however, one of the major problems encountered with the tax reform turned out to be the general lack of support and enthusiasm for reform from the tax administration. It is very hard to put a new system in place if those who are supposed to make it work have no interest or incentive to do so. Indonesia offers yet another instance demonstrating that close attention must always be paid to the administrative dimension of tax reform.

Finally, the political conditions prevailing in Indonesia at the time of the reform, and indeed until recently, should be considered. Essentially, Indonesia was a one-party state with a strong and continuing government, not least in the economic sphere. As already mentioned, the Indonesian experience shows that a comprehensive reform can indeed be implemented quickly and quite successfully in a developing country. But perhaps one important reason this could be done was that no one outside the technical team and the top political leadership really had any opportunity to comment on, or provide input into, the proposals. It was thus possible to develop and carry through to a surprising extent a comprehensive and rational tax reform. Would it be equally possible to do so in Indonesia today? Is this a good thing or a bad thing?

3.2. Comprehensive gradualism: Colombia[27]

One way to begin to answer these questions may be to consider briefly another country prominent in the list of tax reformers – Colombia. Colombia differs from Indonesia in many ways, but two differences seem most relevant in this context. First, despite its well-known and continuing internal political problems, Colombia is almost the antithesis of Indonesia in that it has had constant changes of government and that no Colombian government can formulate and largely adopt reforms – let alone comprehensive reforms – almost on its own, as essentially occurred in Indonesia. In Colombia, everything is debated in public, often by individuals who were e.g. the last Minister of Finance or who will likely be the next one. In addition, despite this constantly changing set of public sector decision-makers and the general openness of its policy process, Colombia has, over the years, managed to formulate and implement a surprising number of important tax reforms – reforms that again are almost entirely "owned" by Colombian policy entrepreneurs (although Colombians, like Indonesians, have proved to be very adept at utilizing foreign expertise over the years).

To oversimplify a great deal, Indonesia in the 1980s was a one-party state in which a technocratic elite essentially conceived and implemented, with little public discussion, a major one-time comprehensive tax reform. Colombia, in contrast, has a relatively open multi-party system in which a constantly changing technocratic elite argued vociferously in public about a series of important tax reforms. Nevertheless, over the years, Colombia has made numerous important policy changes. Neither country perhaps did as much as it could or should have with respect to improving administration in general, and neither did much to ensure that the administration supported policy reforms rather than worked actively to vitiate them.[28] Moreover, if one judges tax reforms in terms of such quantitative measures as the size of the tax ratio or the estimated distributive impact, it is not all that clear that either country has really had much success.[29] Nevertheless, major tax reforms did undoubtedly occur in both countries, although in a very different way.

In contrast to Indonesia's "big bang" of 1983, for example, Colombia had a series of lesser tax reforms in 1953, 1960, 1974, 1983, 1986 and 1990.[30] The 1974 and 1986 reforms in particular were preceded by major foreign-led technical missions, commissioned and paid for by the Colombian authorities. (In 2002, yet another such mission reported, although as yet no major legislative initiatives have followed.) In contrast to Indonesia, almost all of these reforms – like most of the many other tax changes that occurred over this period – were motivated primarily by economic crises, often resulting from external shocks, that led to a demand for new revenue.

In view of Colombia's unusually lengthy experience with tax reform and its obvious openness to influence from abroad, it is not surprising that, to some extent, what Colombia has done over the years to reform its tax system has reflected not just changing circumstances but also changing ideas. The earlier reforms, for example, reflected the shifting intellectual dominance of concerns with progressivity and incentives, while the 1986 (and later) reforms reflected the growing influence of "market-directed" growth ideas. Despite this intellectual and economic openness, however, both the nature and to a considerable extent the timing of Colombia's reforms have been largely dominated by domestic political concerns, particularly the need to maintain the somewhat fragile stability of key national political institutions. Perhaps in part because of the attention paid to pressing economic and political

27. This section is based largely on World Bank, *World Development Report 1988* (Washington, D.C., 1988); McLure, Jr., Charles E., "Analysis and Reform of the Colombian Tax System", in Gillis (ed.), supra note 16; McLure, Jr., Charles E. and George Zodrow, "Thirty Years of Tax Reform in Colombia", in Thirsk (ed.), supra note 21; Shome, Parthasarathi (ed.), *Comprehensive Tax Reform: The Colombian Experience* (Washington, D.C.: International Monetary Fund, 1995); and Urrutia, Miguel, "The Politics of Fiscal Policy in Colombia", in Urrutia, Ichikawa and Yosimura (eds.), supra note 21. For a longer-term perspective, see Bird, Richard M., *Taxation and Development: Lessons from Colombian Experience* (Cambridge, Mass.: Harvard University Press, 1970).

28. As, for example, was noted in Tanzi, Vito, *Public Finance in Developing Countries* (Cheltenham, England: Edward Elgar, 1991), at 191, recommendations to reduce the protectionist use of customs duties seldom have the support of customs officials who would lose power and influence as a result.

29. In Mexico – a country which in some ways combines certain characteristics of Indonesia (one-party state, oil revenues) and Colombia (cultural, geographic) – one of the most striking features of the various tax changes that have taken place over the decades (see e.g. Gil-Diaz, Francisco, "Tax Reform Issues in Mexico", in Boskin and McLure (eds.), supra note 21; and Gil-Diaz, Francisco and Wayne Thirsk, "Mexico's Protracted Tax Reform", in Thirsk (ed.), supra note 21) has been how very little apparent effect they had on the tax ratio (taxes as a percent of GDP), which remained almost constant. In Martinez-Vazquez, Jorge, "Mexico: An Evaluation of the Main Features of the Tax System", Working Paper 01-12, International Studies Program, Andrew Young School of Policy Studies, Georgia State University, November 2001, the author suggested several possible explanations for this constancy: (1) the reforms in tax structure may have been undermined by unrelated ad hoc measures, (2) they may have been offset by administrative deterioration, or (3) one or both of the preceding may have occurred less by accident than by intention. This last point perhaps suggests that a "good" tax reform may be like a "good" seat belt law, that is, if everything else stayed the same, lives would be saved, but things do not stay the same – some people drive faster, and death rates are unchanged.

30. See Shome (ed.), supra note 27.

factors, a continuing characteristic of Colombian tax reform has been the failure to deal adequately with the often overriding administrative aspect of tax reform. In turn, perhaps partly for this reason, despite such major changes as the introduction of a VAT, from a long-term perspective, one of the more striking characteristics of Colombia's changing tax system has been what has been called the striking "inertia" of many of its fiscal institutions.[31]

No tax reform in Colombia has ever been, or seems likely to be, either fully comprehensive or the last word on the matter. Instead, over time, the country's periodic reviews of particular aspects of the tax system have resulted, piece by piece, in the gradual evolution and adaptation of its tax system to changing circumstances. No comprehensive revolutionary package was proposed or implemented. Instead, incrementally, Colombia's system moved with the times.

In addition to noting that – as is true in all countries – tax reforms are inherently political, that good reforms have to pay close attention to the detailed reality of the country, and that if policy cannot be administered it is not good policy, McLure and Zodrow drew the following lessons from Colombia's experience:[32]

(a) Tax reform requires a long gestation period. Major changes (such as those in 1974) followed over five years of discussion and development subsequent to a major tax reform report. Ideas were put forth in the regime of one (four-year) President, debated over the next, and implemented under a third. Despite sometimes marked changes in government policy and frequent changes in top personnel, a certain continuity of ideas was sustained until it came to fruition – or not, as of course often proved to be the case.

(b) Tax reform studies serve an important educational purpose and should be widely disseminated. One reason that ideas lived on in Colombia is that they were published, taught in universities and widely discussed, thus in part shaping the agenda for future policy.[33]

(c) Reforms occur when countries can no longer put them off. (As mentioned above, the Indonesian case offers a counter-example.)

(d) Advice is more likely to be heeded when it is sought than when it is offered gratuitously. To put it crudely, countries that do not themselves have to pay for advice often appear to value it at what they paid. The "round basket" in every country is full of unsolicited advice.

3.3. Transitional approaches: Poland and Belarus[34]

In a recent review of experience with tax reform in transitional countries, Martinez-Vazquez and McNab drew a number of interesting lessons.[35] First, they stressed that where a country ends up and how fast it gets there depend to a considerable extent on where it starts: initial conditions matter – a lot!

Second, they argued that too many rapid, incremental, crisis-driven changes introduced without the framework of a comprehensive strategy give rise to many avoidable costs, not least because of the continued "interventionist" nature of policy (tax incentives, etc.). A more deliberate approach allows for more consensus-building and more successful reform.

Finally, they emphasized that the policy reforms that were most successful were accompanied by complementary reforms in such critical areas as accounting and legal systems, tax administration and intergovernmental fiscal relations.

The two cases discussed briefly here illustrate some of the background behind such arguments. Fiscal problems remain high on the policy agenda in many of the transitional countries of Eastern and Central Europe. Some of these countries have already had serious fiscal crises; others soon may. Moreover, measures taken to deal with immediate fiscal crises may make matters worse. Imposing surcharges on existing taxes or inventing new "nuisance" levies on those already caught in the tax net, for example, exacerbates the already considerable disincentives to the expansion of legitimate private enterprise and results in still further expansion of the underground economy.

In their short fiscal history since emerging from a command economy, most transitional countries have followed neither an "optimal" reform pattern – that is, gone at once to what might be considered a desirable long-term tax system once the transition to a basically market-oriented economy is complete – nor an explicitly interim (transitional) pattern – that is, one explicitly designed to fill the passing fiscal gap while being sufficiently flexible to accommodate the inevitable twists and turns of the transition process.[36] Instead, the tax system now in place in many transitional countries often appears to reflect an uneasy, and almost certainly unstable, compromise between these two patterns.

One reason for this outcome may be that insufficient attention has been paid in designing new tax systems to the needs (and possibilities) of the moment.[37] The long-run aim of designing a tax system appropriate for a new market-oriented economy may not mesh well with the urgent need to meet budgetary requirements, and the result may be that ad hoc measures to raise revenue may hinder long-term reform goals. Another reason may be the persistence

31. World Bank, supra note 27.
32. McLure and Zodrow, supra note 27.
33. This is consistent with the advice in Shoup, Carl S., "Melding Architecture and Engineering: A Personal Retrospective on Designing Tax Systems", in Eden, Lorraine (ed.), *Retrospectives on Public Finance* (Durham, N.C.: Duke University Press, 1991). It is, however, quite contrary to what was done in Indonesia (Asher, supra note 22) or, indeed, to the practice followed by the International Monetary Fund (Tanzi, Vito, "The IMF and Tax Reform", in Bagchi, Amaresh and Nicholas Stern (eds.), *Tax Policy and Planning in Developing Countries* (New Delhi: Oxford University Press, 1994)).
34. This section is based in large part on Bird, Richard M., "Tax Policy and Tax Administration in Transitional Countries", in Lindencrona, G., S.-O. Lodin and B. Wiman (eds.), *International Studies in Taxation Law and Economics* (London: Kluwer Law International, 1999).
35. Martinez-Vazquez, Jorge and Robert M. McNab, "The Tax Reform Experiment in Transitional Countries", 53 *National Tax Journal* 273-298 (June 2000).
36. As noted in 2.2., McIntyre and Oldman, supra note 15, cited the need for such flexibility as one of the key aspects of managing tax reform successfully.
37. A point stressed in Martinez-Vazquez and McNab, supra note 35.

of political and bureaucratic tendencies to "over plan" private investment through the excessive use of incentives. The "inertia" of fiscal institutions mentioned above with respect to Colombia is a phenomenon found around the world. A third reason may simply be that inadequate time and attention have generally been devoted to the creation of a tax administration capable of coping with the difficult circumstances facing transitional countries.

These general points may be illustrated by the experience of two transitional countries in the early 1990s – Poland, one of the leaders of the process, and Belarus, one of the laggards. The World Bank placed Poland at the head of the transitional class in terms of the extent of economic liberalization in the 1989-95 period, while Belarus came last among the European transitional countries in this respect and was trailed only by three small Central Asian republics.[38] Private sector output accounted for close to 60% of Poland's GDP in 1995; the comparable figure in Belarus was little more than 10% – or less than most Central Asian republics. Although neither Poland nor Belarus is necessarily representative of transitional countries as a whole, it may not be too misleading to consider them as representing two extremes of the transitional process.

3.3.1. Poland

Poland's tax system underwent fundamental reform in the early 1990s. The old system of central-planning taxes was completely overhauled and replaced by a more conventional modern system based on a personal income tax (PIT, introduced in 1992), an enterprise (corporation) income tax (CIT, introduced in 1989), a value added tax (VAT, introduced in 1993), a few excises, and import taxes. This is a classic example of a major tax reform: the basic structure of Poland's tax system was altered substantially to fit better the new market-oriented reality of its economy.

Unfortunately, the maturation process of tax administration is much slower than that of tax policy. It takes much longer to recruit and train people in new skills and to adapt institutional structures to new economic realities than it does to write new laws. Launching a PIT with over 20 million new taxpayers, not to mention a VAT the next year, was not easy. Much needed to be done to adapt tax administration both to the new tax system and to the new economic environment.

With respect to income taxes, for example, two basic problems had to be faced. The first was the need to shift from taxing enterprises to taxing households. The second, somewhat contradictory, problem was the need to maintain the enterprise tax base in the short run in the face of declining profits in the state enterprise sector and the expansion of the increasingly difficult-to-track private sector. Initially, Poland seemed to have some success in the first of these tasks and to have encountered some problems with respect to the second. The new PIT, for example, yielded 6% to 8% of GDP in 1992-93 (most of which came from wage-related income, including pensions), which represented a substantial increase over the 3% to 4% yielded by the old wage tax. On the other hand, as in many transitional countries, taxes on enterprises fell sharply – from a high of 16% of GDP in 1990 to little more than 4% in 1993. In reality, however, as often turns out to be true when one probes beneath the surface, less appears to have changed than meets the eye.

The decline in profits taxes, for instance, was more apparent than real because budgetary subsidies to enterprises fell equally sharply. The net result of this offsetting factor was that there was essentially no real budgetary impact from this apparently drastic change in taxation. The "net" (of subsidy) profits tax was probably only about 4% to 5% of GDP before the transformation process began, and it remained at about the same level. Similarly, to some extent, the increase in personal taxes was offset by compensating increases in transfers to households (pensioners and government employees) that accompanied the introduction of the PIT. Since pensions and wages were grossed up by the basic 20% PIT rate – the rate applicable at the time to over 90% of income tax payers – there was again no net flow of revenues to the budget from this apparent increase, at least initially.

Reality may thus have changed less than the tax statistics suggest. In terms of tax administration, however, there was a major change in how the profits of enterprises are taxed. Many more firms than before had to be dealt with and in an entirely different manner. Similarly, the administration of the PIT changed drastically. Personal taxes now had to be collected for the most part directly from millions of taxpayers, of whom all too many had to come into direct contact with the tax office owing to certain (avoidable) structural features of the PIT law (notably housing reliefs and the provision for joint filing). Although 80% of the PIT continued to be collected through withholding on wages and pensions, even in these cases forms were still received and processed (often monthly) at the level of the individual.

Finally, as dramatic and in many ways as successful as Poland's introduction of VAT in 1993 was, in 1994, as in pre-reform years, almost half of the domestic VAT receipts still came from the three traditional excise goods – alcohol, tobacco and motor fuel (ATF). Since most of the balance of indirect tax revenues came from taxes imposed on imports (VAT, tariffs, and import surcharges), in total less than 10% of consumption taxes were initially contributed by the rest of the VAT system (that is, the part not levied on imports or on the ATF goods). To put this point another way, prior to the introduction of VAT, Poland collected 5% to 6% of GDP in the form of "turnover taxes" on domestic firms (excluding the ATF products). Immediately after the introduction of VAT, it collected only about 1% to 2% (net) of GDP from these firms (or those that replaced them). In part, this decline reflected the extent to which taxes were – quite correctly from an economic perspective[39] – removed from intermediate goods and exports due to the introduction of VAT. Viewed from the perspective of tax administration, however, the main result of this important and basically desirable change in indirect taxation was again to increase the workload of the adminis-

38. World Bank, *World Development Report 1996* (Washington, D.C., 1996).
39. "Untaxing" intermediate goods is, of course, a central prescription from the optimal tax literature.

tration and, as in the case of the CIT and the PIT, to alter and make more difficult the task of tax enforcement.

The situation after tax reform in Poland was thus rather paradoxical. On the one hand, most revenue was still collected from essentially the same sources as before the transition: the sales, profits and wages of large enterprises. On the other hand, to perform its task, the tax administration now had to interact directly with a greatly enlarged, and increasingly aware, taxpayer population. Unfortunately, such mundane administrative concerns were seldom factored into the tax reform proposals.[40]

3.3.2. Belarus

In contrast to Poland's experience, at first glance the tax system in Belarus – still largely unreformed in the early 1990s – appeared to have some positive features, at least from an administrative perspective. By basically maintaining the old tax (and accounting) system, Belarus avoided some of the problems encountered in countries such as Poland that moved more quickly to "Western-type" tax systems. Minimizing the changes needed in accounting practices (and much else) clearly reduces the burden of adaptation on both enterprises and the tax administration. Similarly, by continuing in practice to rely heavily essentially on variants of the traditional taxes on state enterprises, revenues were maintained fairly well. Belarus was thus, to some extent, saved from some of the dangers and costs of transition by the very slowness of its move away from the pattern of a command economy.

The price of such gradualism is that not much was done. Significant problems remain to be resolved with respect to taxation in Belarus. The very fact that Belarus kept so closely to the old system gave rise to increasing problems for the tax administration, increased compliance costs for enterprises, and in all likelihood reduced revenues for the state. As the private sector develops and as state enterprises become more tax-sensitive and respond to the many opportunities already open to them to manipulate the tax system, some aspects of the tax structure became increasingly untenable. Revenue pressures were met largely by imposing further taxes on the few firms "trapped" within the formal tax system. No real effort was made to reach the new "hard-to-tax" sector where much of the growth in most transitional economies has taken place. In addition, Belarus, like many transitional countries, further complicated matters by relying on tax incentives – particularly for foreign investments – rather than on low, stable taxes as a strategy to encourage enterprise development.[41]

General consumption taxes now constitute the mainstay of most revenue systems around the world. Such taxes seem likely to play the same role in most transitional countries not only in the long run but also in the short run – the "transition". Many have argued that a broad-based consumption tax – usually a VAT – is a much sounder basis for tax reform than a broad-based personal income tax.[42] In principle, a good VAT should be based solely on sales revenue and the cost of inputs purchased from other registered taxpayers. In Belarus, however, in a system that continued to adhere closely to the old central-planning accounting framework, the determination of production costs lay at the heart of VAT (and, for that matter, the profits tax). Determining such costs is a complex process in both principle and practice, prone to error and manipulation. This approach may have worked satisfactorily when prices were stable and predetermined as in a command economy, and all the tax system essentially did was to channel some enterprise revenues into budgetary accounts. But it is clearly not satisfactory in any country moving down the transitional road. Improving the administration of a fundamentally bad tax is not necessarily an improvement.

Rather than attempting to adapt the tax administration to the tax system, in this instance more attention should likely be paid to ensuring that the system itself – both the tax structure and basic tax procedures – is compatible with a modern economy.[43] One path to doing so – although not one that is likely to be either easy or tranquil – is to encourage more informed public discussion of tax matters and the general growth of knowledge and expertise in the fiscal field. Unsurprisingly, many transitional countries, like many developing countries, remain far from this ideal, with very little "reality check" being applied to the countless proposals for special tax reliefs and incentives that too often constitute public discussion of tax matters.

4. LESSONS FROM EXPERIENCE

It sometimes seems as though no one who has written on the subject of tax reform in any developing, transitional or even developed country has been able to refrain from drawing some general "lessons" from the experience. While time and space do not permit summarizing all that people think they have learned about how to manage the tax reform process in developing countries, one way to wrap up this discussion is to set out a few of the many "rules for reformers" to be found in the large relevant literature.

In an interesting early analysis, Forte and Peacock explored some of the implications for tax reform of an analysis by Breton of the many ways in which citizens can influence policy outcomes other than by simply voting periodically for a certain politician or political party.[44] People may, for example, organize or support a pressure group to put forth policy positions and influence the debate at the design stage. They may employ professional consultants to represent their interests in influencing legis-

40. For further discussion of Poland's case, see Bird, supra note 5.

41. As noted earlier, Indonesia is the classic case of a country that consciously chose this strategy in the early 1980s. But as noted in Bird, Richard M. and Duanjie Chen, "The Fiscal Framework for Business in Asia", in Dobson, Wendy (ed.), *Fiscal Frameworks and Financial Systems in East Asia: How Much Do They Matter?* (Toronto: University of Toronto Press, 1998), by the end of the 1990s, Indonesia appeared to impose one of the highest marginal effective tax rates on foreign investors in Asia.

42. E.g. Gillis, Malcolm, "Tax Reform: Lessons from Postwar Experience in Developing Nations", in Gillis (ed.), supra note 16.

43. For a detailed discussion of this problem, see World Bank, "Ukraine: Tax Policy and Tax Administration", Washington, D.C., September 2002.

44. See Forte, Francisco and Alan Peacock, "Tax Planning, Tax Analysis, and Tax Policy", in Peacock, Alan and Francesco Forte (eds.), *The Political Economy of Taxation* (Oxford: Basil Blackwell, 1981); and Breton, Albert, *The Economics of Representative Government* (Chicago: Aldine, 1974).

lation at the drafting stage. If they do not succeed in blocking or altering the prospective legislation to their taste, they can continue the fight through various stages of implementation through the administrative and/or judicial process. If none of this works, they can use the same expertise to find legal, or possibly illegal, ways around the legislation through avoidance or evasion. And, finally, they can always remove their persons and assets from the taxing jurisdiction.

As Musgrave showed,[45] how those who wish to influence tax policy organize to do so seldom fits neatly into such aggregate economic categories as "capital" and "labour". Income groups – the "rich" and the "poor" – may come a bit closer but are again far too aggregative. Interests may vary by age, by region, by source of income, and in many other ways. Different people may, for different purposes, fall into a number of different overlapping groups. An employed home owner living in a particular city, for example, has some things in common with a self-employed home owner, others in common with an employed tenant, and still others in common with all city residents. Big businesses, small businesses, farmers, independent professionals – these and many other categories – may be affected to varying degrees by particular proposals and may have varying opportunities open to them (at different costs) to influence the final policy outcome. These context-specific details matter because, in the end, what determines whether a particular tax change is made is invariably a political calculation by those in a position to make the decision as to the relative (and relevant) costs and benefits of action (or inaction).[46]

Such analysis tends to tell us that precisely how a particular reform proposal is structured may determine its fate. An ambitious income tax reform in Canada in 1981, for example, failed essentially because many different groups, including some that would have benefited from the proposal as a whole, objected to a particular component of the reform. The result was sufficient political unrest to lead to major modification of many aspects of the reform.[47] On the other hand, some reforms may encounter severe difficulty if just one component is seen to affect very adversely a small but sufficiently powerful group, whether senior civil servants in Jamaica or policemen in Bolivia. In short, there is a "market" for tax reform and – as those in the business of "selling" such reforms soon learn – it is essential to create sufficient political demand for reform, if reform is ever to become reality.

As Nerré noted,[48] many groups in any society are involved in the process of tax reform – politicians, tax officials, academics, tax practitioners and, not least, taxpayers themselves. None of these groups is monolithic. Some members of each group may initiate change, some may facilitate (or block) it, and some may simply accept it. But all, in one way or another, are relevant players in the tax reform game, and their ideas and interests have to be factored into the process in some relevant way if it is to succeed and be sustainable.

4.1. Lessons from experience in developed countries

Tax reform is little if at all easier in developed countries than in developing or transitional countries. Given the preponderance of scholarly activity in developed countries, however, there is a much larger literature analysing the apparent factors leading to success or failure in tax reform efforts in developed countries. One small example will have to suffice here. In an interesting little book on successful tax reform, Sandford, who defines "success" in terms of the extent to which the stated objectives were attained (without undesirable side effects) as well as their sustainability, drew the following conclusions from an examination of tax reforms in six English-speaking democracies:[49]

(a) The essential requirement for success is a strong political will exemplified by a champion (or champions) prepared to put his/their reputation on the line.[50]

(b) The champion must be strongly supported by the chief executive.

45. Musgrave, Richard A., "Theories of Fiscal Crisis: An Essay in Fiscal Sociology", in Aaron, Henry J. and Michael J. Boskin (eds.), *The Economics of Taxation* (Washington, D.C.: The Brookings Institution, 1980).
46. For an important study along these lines, see Hettich and Winer, supra note 8, and for an application of this general framework to Canadian federal tax policy, see Gillespie, W. Irwin, *Tax, Borrow and Spend: Financing Federal Spending in Canada, 1867-1990* (Ottawa: Carleton University Press, 1991).
47. The story is told in Gillespie, supra note 46. Interestingly, Gillespie himself saw the outcome as something of a policy success in that the government was, in his view, able – by including a variety of unpopular proposals in the reform package – to "flush out" political opposition to particular proposals from disparate groups and thus to prevent opposition concentration on the most important revenue measure (de-indexing the income tax), which was therefore successfully implemented. Others (e.g. McQuaig, supra note 12, and St.-Hilaire and Whalley, supra note 20) presented this episode quite differently – as a major reform attempt that failed. For good discussions of the tax reform process in Canada in general, see Hartle, Douglas G., "Some Analytical, Political and Normative Lessons from Carter", in Brooks, W. Neil (ed.), *The Quest for Tax Reform: The Royal Commission on Taxation Twenty Years Later* (Toronto: Carswell, 1988); and Good, David A., *The Politics of Anticipation: Making Canadian Federal Tax Policy* (Ottawa: School of Public Administration, Carleton University, 1980).
48. Nerré, Birger, "The Concept of Tax Culture", in National Tax Association, *Proceedings 94th Annual Conference* (2001).
49. Sandford, Cedric (ed.), *Successful Tax Reform: Lessons from an Analysis of Tax Reform in Six Countries* (Bath, England: Fiscal Publications, 1993). Even leaving aside the huge US literature, interesting examples of other approaches include such major studies as Boskin and McLure (eds.), supra note 21; Rose, Richard and Terence Karran, *Taxation by Political Inertia* (London: Allen and Unwin, 1987); Messere, Ken, *Tax Policy in OECD Countries* (Amsterdam: IBFD Publications, 1993); Peters, B. Guy, *The Politics of Taxation: A Comparative Perspective* (Cambridge, Mass.: Blackwell, 1991); and Steinmo, Sven, *Taxation and Democracy: Swedish, British and American Approaches to Financing the Modern State* (New Haven: Yale University Press, 1993).
50. In Bahl, Roy W., "Implementation Rules for Fiscal Decentralization", in Rao, M. Govinda (ed.), *Development, Poverty, and Fiscal Policy* (New Delhi: Oxford University Press, 2002), the author similarly stressed in the context of decentralization that there must be a strong "champion" if major institutional reform is to get off the ground and be successful in any country. But see Petrie, Murray, *Organisational Transformation: The Income Support Experience* (Wellington, New Zealand: Department of Social Policy, 1998), an interesting study of a major social policy reform in New Zealand, where the author noted that a champion may not be enough for sustainability. Without a catalytic personality – someone with a clear vision, high energy and a strong leadership role – nothing may get done. But it often takes a very different kind of person to translate a vision, once accepted, into reality on the ground. Champions, it seems, must be followed by "consolidators" if reforms are not to fade away once the initial transformative episode passes.

(c) A good "package" reform – a "big bang" – is, if it can be accomplished, better than an incremental approach that is too likely to lose focus and to degenerate into ad hoc measures.

(d) The most successful packages are those in which, as a New Zealand reformer put it, "the pluses are real and substantial enough for ordinary people to see past the minuses".[51]

(e) Up to a point, the more openness, consultation and discussion there is, the more successful the reform is likely to be, provided, however, that "... the government [gives] ... a firm lead, the forum of discussion [is] ... appropriate and the process [goes] ... forward with speed".[52]

(f) Less important than these grand political considerations, but still important determinants of success or failure, are such matters as a strong technical team, integrating legal drafting with policymaking, drawing on private sector expertise, developing a good programme of education and guidance using all available media and, not least important, consolidating one reform before attempting another.[53]

4.2. Lessons from experience in developing countries

A few years earlier, Gillis[54] had similarly summed up the lessons he drew from a similar major review of tax reform episodes in a number of developing countries, as follows:

First, hurried reforms usually fail. Frustratingly, tax reform tends to be most successful when it is least needed, that is, when it is not undertaken in response to a major fiscal crisis, essentially because crisis-driven reforms tend to be poorly designed and poorly implemented.[55]

Second, reforms tend to be more successful when they involve measures to simplify tax administration and compliance. More generally, reforms that will work with poor administration tend on the whole to be more successful (which is one reason why concentration on personal income taxes is seldom a good approach). Tax administration is not a peripheral, but a central, issue in tax reform.[56]

Third, successful reforms are those that pay attention to implementation issues such as legal drafting, training officials, and even the design of new forms.

Fourth, continuity among the decision-makers responsible for tax policy and implementation helps success, especially of more comprehensive reforms.

Fifth, good reforms do not depend on "gimmicks" such as presumptive taxes and lotteries based on tax receipts.

Sixth, how tax reforms are sequenced with other reforms matters, but it is not clear what sequence is best for success.

Finally, it is also not clear if an incremental or a comprehensive approach to tax reform is best.

Interestingly, Gillis concluded on the optimistic note that "successful tax reform has not been all that uncommon in the middle-income developing countries featured in this volume", although he cautioned that it is not clear whether the experience of these countries tells us anything about prospects in low-income countries.[57]

Around the same time as the Gillis paper, Carl Shoup, one of the pioneer foreign tax advisers of the post-World War II era, summarized what he had learned in his extensive experience of how to organize such missions by distinguishing between tax architecture, tax engineering and tax administration.[58] By "tax architecture" Shoup meant the design of the key features of each tax and the tax structure as a whole. "Tax engineering", on the other hand, he saw as the more detailed decisions that have to be made on each of the many substantive issues that has to be decided within any given tax structure; and, of course, "tax administration" is concerned with how to implement whatever the architects and engineers come up with. Essentially, Shoup's argument is that "tax engineering" – the design of the details – is an area in which foreign expertise may be the most fruitful and, moreover, that this was a task in which lawyers and accountants could often be more helpful than economists. Interestingly, Shoup also noted that sociologists, social psychologists and political scientists could, in principle, also contribute usefully to tax missions both in fitting the "tax engineering" to the environment and in understanding the political setting.[59] To this author's knowledge, no one seems to have taken this advice seriously. Perhaps they should.

51. Roger Douglas, quoted in Sandford, supra note 49, at 203.
52. Sanford, supra note 49, at 208. For a useful discussion of some Canadian examples of how *not* to have consultation about tax reform, see Hartle, supra note 47.
53. Sandford, supra note 49, Chapter 9 is worth reading in its entirety on these and many other points. See also his earlier look at the tax policy process in the United Kingdom (Robinson, Ann and Cedric Sandford, *Tax Policy-Making in the United Kingdom* (London: Heinemann Educational Books, 1983)) and his later reprise of the tax reform issue in Sandford, Cedric, *Why Tax Systems Differ: A Comparative Study of the Political Economy of Taxation* (Bath, England: Fiscal Publications, 2000). The last few sentences of the latter book (at 196) deserve special note: "Perhaps the art of statesmanship in tax policy-making is to convince the population, or at least a majority, of the rightness of the tax reform proposals so that good economics does become good politics .... This is no easy task. It may well require, as one interviewee said in explaining the success of the United States tax reform in 1986, some 'sheer dumb luck'."
54. Gillis, supra note 42.
55. For a somewhat different view, see McLure and Zodrow, supra note 27, and the case of Colombia discussed in 3.2.
56. No one has made this point more clearly than Alex Radian in "On the Differences between the Political Economy of Introducing and Implementing Tax Reforms: Israel 1975-1978", 11 *Journal of Public Economics* 261-271 (1979). See also Radian, Alex and Ira Sharkansky, "Tax Reform in Israel: Partial Implementation of Ambitious Goals", 5 *Policy Analysis* 351-366 (1979); and the discussion of this article in Bird, Richard M. and Oliver Oldman (eds.), *Taxation in Developing Countries* (Baltimore: Johns Hopkins University Press, 1990).
57. Gillis, supra note 42, at 517.
58. Shoup, supra note 33. For a useful review of the various missions led by Shoup, see Gillis, Malcolm, "Legacies from the Shoup Tax Missions: Asia, Africa, and Latin America", in Eden (ed.), supra note 33.
59. Somewhat curiously, Shoup did not discuss what some observers (e.g. Gillis, supra note 58) have seen as the major contribution of Shoup's own missions, namely, what might be called their "educative" function of expanding the knowledge of, and expertise in, tax matters generally – a function that was greatly facilitated by his efforts to ensure that mission reports were published in the native language and widely circulated.

4.3. Lessons from the experience of the World Bank and IMF

Although by far the greater proportion of the extensive work sponsored by various international organizations on tax reform over the decades has, unsurprisingly, concentrated mainly on substantive questions, from time to time some observations have been made not just on *what* should be done but on the key question of *how* to do it. A 1991 World Bank study, for example, summarized the main lessons learned from the Bank's experience with tax reform in developing countries up to the end of the 1980s.[60] The principal lessons with respect to the process of tax reform are said to be several:

First, tax reform must be viewed systemically rather than in a piecemeal fashion. The hope is expressed that "taking a systems view of tax reform can help to overcome political pressures and to counter vested interests".[61]

Second, tax structure reform should be accompanied by tax administration reform, and laws should be made simpler, not more complex, in order not to overload the administration.

Third, tax reform must take carefully into account the initial conditions of the country, such as its constitution and its "tax culture".[62]

Fourth, for tax reform to succeed, there must be domestic ownership of the proposals.

Finally, careful attention must be paid to transitional arrangements to ensure the credibility and sustainability of reform.

A few years later, summing up the lessons drawn from detailed case studies of tax reform in eight developing countries, another World Bank study similarly devoted a few pages to the question of "how to do it":[63]

(1) Tax reform can be accomplished only when the time is ripe, such as when a new government comes into power and faces a major revenue problem. It is thus critical to have appropriate policy measures ready – on the shelf, so to speak – when that time comes.

(2) Successful reform requires a cadre of policymakers and experts who have detailed knowledge of and involvement with the existing system and who take responsibility for the reform.

(3) Substantial efforts must be made to educate both the tax administration and the public and to get the public "on board" supporting the reform.

(4) Good tax reform cannot be carried out in isolation: it requires both good tax administration and good expenditure policy; otherwise, it is unlikely to be sustainable.

Far more than the World Bank, for many years the Fiscal Affairs Department of the International Monetary Fund – for which the somewhat inappropriate acronym is FAD – has been the major international player in the tax reform game. It is thus of special interest to consider, finally, what the FAD seems to have learned about tax reform from almost 40 years of experience. Of course, it would be presumptuous to pretend that such a large and complex organization dealing with a huge variety of issues in a large number of countries has any fixed or definitive set of "rules for reform". Still, perhaps some idea of its evolving ideas may be obtained by considering briefly a few of the many writings of the FAD's two longest-serving directors, Richard Goode and Vito Tanzi.

Shortly after Goode retired after almost 20 years as head of the FAD, he wrote an interesting book in the last chapter of which he offered some general advice on how to make policies "effective and efficient".[64] At the risk of still more oversimplification, that advice may perhaps be summed up in a few key propositions:

(a) Policies must be formulated clearly and realistically. Incremental change may lead to missing some big changes that are needed, but it puts much less demand on scarce policymaking, administrative and compliance resources and is hence more likely to succeed. Overly ingenious devices and undue reliance on discretionary administration are to be avoided.

(b) Much more attention to organization, management and procedures is needed if policy initiatives are to be successful.

(c) Corruption is a plague and should be prevented as much as possible by making laws simpler and reducing administrative discretion.

(d) Big changes can be made only occasionally, when the circumstances are right; thus, it is critical to be prepared to take advantage of such occasions when they arise, for example, by creating some research and analysis capacity both within and outside the government.

Subsequently, Goode reflected further on why so many proposals for tax reform, especially those by visiting experts, were so seldom implemented.[65] He identified several possible reasons – inadequate information to permit good analysis, the lack of any real political constituency for tax reform and, not least, the bad advice often offered (such as the advocacy of "all or nothing" comprehensive reform packages and the neglect of real administrative problems). In particular, he stressed the inherent political obstacles to reform, which as a rule was only possible when more revenue was needed, so that invariably there were groups that would lose and hence strongly oppose change. His conclusion, unsurprisingly, was that incremental changes made when possible were more or less the only way to go and that it was important to make sure that such changes were worthwhile ones.

While Goode's successor as head of the FAD, Vito Tanzi, has written even more extensively about such matters,[66]

60. World Bank, *Lessons of Tax Reform* (Washington, D.C., 1991).
61. Id. at 44.
62. For a recent discussion of this rather tricky concept, see Nerré, supra note 48.
63. Thirsk, Wayne, "Overview: The Substance and Process of Tax Reform in Eight Developing Countries", in Thirsk (ed.), supra note 21.
64. Goode, Richard, *Government Finance in Developing Countries* (Washington, D.C.: Brookings Institution, 1984).
65. Goode, Richard, "Obstacles to Tax Reform in Developing Countries", in van der Kar, H.M. and B.L. Wolfe (eds.), *The Relevance of Public Finance for Policy-Making* (Detroit: Wayne State University Press, 1987).
66. For a useful collection of his writings, see Tanzi, supra note 28.

the discussion here considers only some remarks in a recent review paper which, for the most part, focused on substantive issues.[67] Before getting into all the things that developing countries should be doing, however, this paper noted the substantial obstacles to tax reform in such countries, citing the lack of good data, the limited capacity of administration, the economic structure and, especially, the political factors which are said to be "less amenable to rational tax policy than in advanced countries".[68] While the context of this last remark is unclear, it appears that what the authors had mainly in mind is the highly unequal income distribution found in many developing countries and the consequent concentration of political power in the hands of the wealthy, who, it seems to be presumed – although they did not discuss this – have most to lose and least to gain by expanding state revenues. This important argument was recently discussed in detail by Lledo, Schneider and Moore in a paper focusing on Latin America, the region of the world in which income inequality is perhaps most marked. These authors stressed that most countries have "... long been characterized by an interlocking syndrome of (a) high economic, social and political inequality; (b) radical disagreement on political institutions and constitutions; and (c) the consequent difficulty of obtaining wide societal consensus over policies to deal with economic problems and crises, such that (d) economic problems can quickly deteriorate into deep, combined political and economic crises".[69] In such circumstances, is meaningful tax reform likely?

One last example may perhaps be related to this point. In concluding an interesting set of case studies of fiscal reforms in six countries, Urrutia and Yukawa[70] stressed that, while there is no evidence that reform is more likely or less likely to succeed under a democratic or authoritarian regime, all successful cases seem to have in common strong "technocratic" leadership of the reform (sometimes with support from international experts as well), supported by a sufficiently strong political leadership to be able to resist undue influence from pressure groups. From this perspective, presumably Indonesia appears to be a better model than Colombia (see 3.). But is a "successful" tax reform necessarily one that is, so to speak, created and implemented largely outside the hurly-burly of domestic politics? One wonders.[71]

5. CONCLUSION

One way to conclude this wide-ranging review of a variety of issues is to consider the following summary presentation of a few of the major questions would-be reformers should consider, as suggested by the preceding compilation of views and approaches to tax reform in developing countries. Broadly, four key questions must be answered:

First, *what* should be done?
- Should one take a comprehensive view or focus on incremental changes?
- Should one focus on the few central issues – those that are critical, solvable and doable – or attempt to deal with all the problems of the present tax system?

Secondly, *how* should it be done?
- Should one try to do everything at once – a package approach – or should one tackle the problem piece by piece?
- Should the aim be to accomplish reform quickly or slowly?

Thirdly, *who* should do it?
- The tax administration?
- The tax policy office?
- A special commission?
- Outside experts?

Fourthly, *when* should it be done?
- When crises demand (or permit)?
- Only after careful study and preparation?
- After full and public discussion?

The "best" answers to such questions are inevitably highly context-specific and can only be determined for a particular country at a particular time. More importantly, one of the key lessons from international experience is that such answers can only be determined *by* that country. Ownership matters. So does leadership. So does a coherent strategy and, of course, so do adequate resources. Good tax policy planning involves economists, lawyers, administrators and – not to be forgotten – adequate discussion with taxpayers. Successful tax reform involves all this plus solid and continuing political support and adequate administrative follow-up. It is not easy anywhere. But it can be done.

In an earlier look at some of these matters, this author suggested some "rules for reformers" in the form of what may be called the "three R's" of good reform – robustness, resiliency and relevancy.[72] As many of the authors cited above have stressed, good planning and policy formulation focus on what matters and what can be done and pay close attention to both detailed design and implementation. Building up adequate institutional capacity in the tax field, both inside and outside the government, is the key to being able to adapt policies to changing circumstances and needs, thus ensuring both "robustness" and "resiliency". As any consideration of the actual tax reform experience in any country quickly demonstrates, however, even the best planning and the best implementation team in the world will not produce useful results without adequate political leadership, careful attention to building the necessary political coalitions, and close attention to the perceived needs of citizens as aggregated through parties, interest groups, and what is now often called "civic society". Even the best product will not sell unless it is prop-

67. Tanzi, Vito and Howell H. Zee, "Tax Policy for Emerging Markets: Developing Countries", 53 *National Tax Journal* 299-328 (June 2000).
68. Id. at 299.
69. Lledo, Schneider and Moore, supra note 3, at 47. For further discussion, see Bird, Richard M., "Taxation in Latin America: Sustainability and the Balance between Equity and Efficiency", paper prepared for the World Bank, June 2003.
70. Urrutia, Miguel and Setsuko Yukawa, in Urrutia, Ichimura and Yukawa (eds.), supra note 21.
71. For some interesting and relevant insights on the futility of the apparent desire to "politician-proof" reform by insulating it from politics, see Robinson, James A., "Politician-Proof Policy", paper prepared for the World Bank, February 2003.
72. Bird, Richard M., "Tax Reform and Tax Design in Developing Countries", 36 *Rivista di diritto finanziario e scienza delle finanze* 297-306 (No. 2, 1977).

erly marketed – to the governing elites, who will have to adopt it, to those who will have to administer it, and finally to the public, who will have to accept it. In the end, therefore, tax reform is inevitably always and everywhere an exercise in practical politics. If economists and other "experts" want to have much impact on the outcome of this process, they will, it seems, have to pay much more attention to packaging and selling their ideas about tax reform in terms that resonate with those who play the political game.

Semantic Scholar extracted view of "MANAGING TAX REFORM" by Richard M. Bird.Â @inproceedings{Bird2004MANAGINGTR, title={MANAGING TAX REFORM}, author={Richard M. Bird}, year={2004} }. Richard M. Bird. Save to Library. Tax reform was specifically designed to make the US a more attractive place in which to invest and to base commercial activity. Indeed, from a pure corporate tax rate perspective, some of the big winners are companies that already hold intellectual property (IP) in the US.Â What US Tax Reform certainly does offer is a compelling argument for businesses to take a closer look at their IP and its position in the value chain. Do you want to move your IP to the US?