



Joseph L. Rotman School of Management
University of Toronto

Rotman

Managing the Reform Process

ITP Paper 0301

Richard M. Bird

April 2003

International Tax Program
Institute for International Business
Joseph L. Rotman School of Management
University of Toronto
Toronto, Ontario
Canada M5S 3E6

Tel: 416 978-2451

Fax: 416 978-0002

Email: iib@rotman.utoronto.ca

Website: <http://www.rotman.utoronto.ca/iib/>

This paper is a preliminary document circulated in this form for the purpose of comment and discussion only. It should not be cited or quoted in this form without the express permission of the authors.

Managing the Reform Process

Richard M. Bird
April 2003

Draft paper for World Bank course on Practical Issues of Tax Policy in Developing Countries, April 28-May 1, 2003

Contents

- I. Introduction
- II. Approaches to Tax Reform
 - 1. The process of tax reform
 - 2. Institutionalizing tax reform
- III. Tax Reform in Action
 - 1. A planned comprehensive approach: Indonesia
 - 2. Comprehensive gradualism: Colombia
 - 3. Transitional approaches: Poland and Belarus
- IV. Lessons from Experience
 - 1. Lessons from experience in developed countries
 - 2. Lessons from experience in developing countries
 - 3. Lessons from Bank and Fund experience
- V. Conclusion

Managing the Reform Process

Richard M. Bird¹

April 2003

I. Introduction

Designing an appropriate and workable tax reform is not an easy task in any country. Getting that reform accepted and then successfully implemented is much more difficult. Managing the whole process of tax reform from inception to conclusion is also 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.

Reforming taxes in any country is thus always a “one-off” operation in the sense that it is something that has to be attempted in the often unique circumstances of that place at that time. Nonetheless, there may be much to be learned from experience with somewhat similar exercises in somewhat related circumstances. A comparative approach to public policy can for example, provide a useful corrective to the apparent belief of many that there must be some simple solution to be found somewhere else in the world that can replace the seemingly unending problems and process of negotiation found in their own country. More than this, much can be learned from studying how different countries have coped with tax reform: although the solutions reached may be different, the basic problems that must be faced are often rather similar. Of course, the comparative approach cannot offer clear prescriptions as to what should be done at any particular time in any particular country. Nonetheless, it can be very illuminating to consider how different countries deal with similar problems and to try to uncover the principal factors that appear to have determined both what has been done, and how successful it has been.

In a sense, the main aim of this paper is simply 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 can learn and profit from both the successes -- transitory though they may sometimes be -- and failures of others. This task is undertaken in Part III of the paper. By way of background, however, Part II first discusses briefly several different perspectives on the tax reform process that may help us understand both the critical elements of the process and the different ways in which it may be approached.

Finally, Part IV reviews some “lessons” that various writers have derived from consideration of such experiences and suggests some possibly useful rules for would-be “reform-mongers”, as Albert Hirschman (1963) once called those in the difficult

¹ Professor of Economics Emeritus and Co-Director of International Tax Program, Rotman School of Management, University of Toronto.

business of trying to bring about policy change in developing countries. Part V concludes.

II. Approaches to Tax Reform

In a recent paper, Lledo, Schneider and Moore (2003) set out a useful categorization of some of the many approaches to tax reform found in the literature. The four approaches they distinguish may be, somewhat cavalierly, categorized as follows:

- *The public economics approach.* Found in any public economics text -- as well as, notably, Newbery and Stern (1987) and Ahmad and Stern (1991) with special reference to developing countries -- in essence the focus in this approach is on setting up a tax system that (in the purest version) 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.
- *The macroeconomic approach* is also common ground among economists, especially those not specializing in public economics. This approach focuses not on the internal structure of the tax system but rather 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, ideas supported on such grounds – though seldom burdened by much consideration of either administrative or political concerns – have sometimes carried considerable weight in tax policy debates. This approach usually stresses the role of taxation in promoting economic growth.
- *The administrative approach*, as discussed at length in Bird (2003) and sources cited there, 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.
- *The political approach*, which 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 see taxation as an integral part of the social contract – 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 legitimation, 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 the most formal of the “political” approaches to tax reform -- the “fiscal exchange” approach associated with Buchanan -- with both the now dominant “optimal” public economics approach and the older so-called “equitable” tax approach (associated with such scholars as Musgrave and Shoup) that shaped much work on tax reform before, say, the late 1980s, may be found in a paper by Hettich and Winer (1985). Without going into the details of their argument, it suffices for present purposes to note that they conclude 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 judgments.
- Offers any satisfactorily explicit way to treat tradeoffs between major objectives.²
- Is grounded in a well-developed public choice analysis.³
- 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.⁴

One need not agree with all these remarks to share their general skeptical conclusion that since none of these approaches factors in satisfactorily 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.

1. The Process of Tax Reform

If theory has relatively little to offer those concerned 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. Since the administrative dimension of tax reform has already been considered in detail in another paper in this series (Bird, 2003), however, it will not be further discussed here.

² Of course, the “optimal tax reform” tradition pretends to do these things, but it appears to convince only those who are already convinced.

³ Subsequently, however, Hettich and Winer (1999) themselves, in addition to Breton (1996), have provided many of the elements of such an analysis.

⁴The major contribution of Ahmad and Stern (1991) was essentially to refocus the optimal tax discussion in this direction.

Moreover, although the formal process of legal authorization – the critical legislative or parliamentary process by which proposed reforms actually become law – has been much less examined, relatively little will be said about it either, other than the following general remarks.

- In some countries, the legislative process is not really independent of the policy formulation process. There can be two very different reasons for this. In many instances, of course, as in most non-democratic states, it is simply because the legislature has no real independence from the executive. In others, 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. Of course, in this instance this occurs not because of any lack of democracy but rather because of the way in which political institutions are structured.⁵
- In other countries – for example, some stable democracies in which the electoral system customarily produces coalition governments or many 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, essentially because 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 is “behind closed doors” (McQuaig, 1987) or in the public arena varies greatly from country to country.
- In yet other countries, however, 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 much more freedom than in most countries. In others, with superficially similar institutional structures, the underlying electoral system may be biased (e.g. Snyder and Samuels, 2001) or the party system may be so weak that individual legislators form shifting coalitions on many issues, in some instances, perhaps reflecting simple corruption. In such circumstances, rather than debate issues in public or attempting to influence the policy formulation process in some overt way, it might be easier (and cheaper) for those who are against particular reforms simply to block them at the legislative level.⁶

⁵ 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. Breton (1996) argues, interestingly, that in such systems, the final policy outcomes may come closer to citizen preferences than in a more open “congressional” system. Hettich and Winer (1999), however, cast some doubt on this proposition.

⁶ For a fascinating study of such shifting coalitions in Ukraine, see Gorbachuk (2002).

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, most attention has been paid in the literature on tax reform to the first stage of the reform process, policy formulation.

2. Institutionalizing Tax Reform

One approach to this issue is to focus on the *substance* of what should be considered. A major question customarily considered in this regard, for example, relates to how comprehensive a good reform package should be, as discussed further in Parts 3 and 4. 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 McIntyre and Oldman (1975). Although much more experience has flowed under the bridge since then, the ideas set out in this study need surprisingly little updating.

Defining the “tax reform process” as encompassing both the formulation and implementation of proposals, McIntyre and Oldman (1975) broadly argue that more careful and comprehensive attention to the 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 give four reasons for this positive view:

1. Better planning will lead to better “packaging” designed both to attract political support and to 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 refuted if proposals are backed up by careful studies.⁷
4. Politicians introducing reforms will have more control of the process in terms of timing and presentation

As McIntyre and Oldman (1975) note, while major reforms will always, in the end, be decided essentially on political grounds, good institutional arrangements may also be critical in preventing reforms for being defeated for the wrong reasons (ignorance and misinformation, for example). Moreover, and importantly, better planning is needed not only for major reforms but also for improving the design and fate of the many “minor” changes continuously needed in any tax system – not least in countries that are chronically short of revenue and under continuing external and internal pressure to deal with revenue shortfalls. On the other hand, even quite good institutional arrangements with respect to studying and developing reform proposals will never be enough to bring about good policy changes in the absence of a coherent strategy, continuing support from

⁷ For a good example, see the discussion of tax incentives in Indonesia in Gillis (1989a).

above, and an acceptable level of administration.⁸ Good policy formulation is thus never enough, but it is presumably always better than its absence, or its opposite.

Although McIntyre and Oldman (1975) correctly stress that the specific institutional arrangements appropriate for any particular country must of course be developed specifically for the conditions of that country, they suggest that such arrangements will almost invariably include a number of key components.

First, in some form or other, every country needs the following simply in order to ensure that the unending “technical” changes that characterize most tax systems are good policy:

1. An organizational unit concerned specifically with drafting tax legislation. Those who have not actually tried to see a “good idea” through to reality can have no idea how important it is to have well-drafted laws and regulations. Without them, ideas will not get very far.
2. Another unit concerned specifically with gathering and analyzing data relevant to tax matters.
3. 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 perhaps collapsed into one unit. Depending on circumstances, some or all of these functions might be carried out by the Ministry of Finance, the budget office, the tax administration, or some combination. In still others, in which there is a relatively independent legislature, it too may need some form of tax policy organizational structure.

Secondly, although many configurations of the different components of the tax policy function are possible, the key question is always where the “central” control lies:

1. 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 current administration.
2. 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.

⁸ Unfortunately, there is another excellent example of this problem in Asia, in this case in the Philippines. As McIntyre and Oldman (1975) note (see also Yoingco, 1969, 1976), the Philippines for many years had by far the best developed and “institutionalized” tax planning process in Asia, and indeed in some respects perhaps in the developing world. The results in terms of good policy, however, are not very evident, essentially for the reasons mentioned in the text.

3. Should it be in the Ministry of Development (or Planning, or whatever it may be called)? Now the problem may be that the ideas developed are completely beyond the effective capacity of the fiscal system.
4. The budgetary office (supposing this to be different from the finance ministry – for example, part of the presidential office)? But then perhaps proposals emerging from this source may be too driven by short-term revenue needs.
5. Might the best answer be to have a multiplicity of sources – to, as it were, have a competition of reform ideas? Many might say that skilled technical resources are too scarce in most developing countries to be thus “wasted” in duplication. But might it not also be argued that good, workable reform ideas are too valuable to establish a monopoly and cut off potential alternative suppliers?

Finally, when major tax reforms are being considered, this “normal tax policy machinery” –however it may be organized and positioned -- usually needs to be expanded greatly. Often, this is done by naming some ad hoc committee of external experts. McIntyre and Oldman (1975) argue, 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 suggest, 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” (p. 44). A question of particular interest in many developing countries is the possible role and limitations of foreign experts in this connection, as discussed briefly in some of the case studies in Part III.

On the whole, experience with special reform commissions, whether foreign, domestic, or mixed, is not all that great. Often, it seems, appointing an “outside” group to study some 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 some other way, or else the commissioning government has gone, and the new brooms are not interested in old ideas.⁹ For this reason, some studies of the tax reform process in countries 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...” (St.-Hilaire and Whalley, 1985, p. 221).¹⁰

⁹ On the other hand, see the discussion of Colombia in Part III.

¹⁰ But such a structure is not enough to do the job on its own: see the case of the Philippines mentioned earlier.

III. Tax Reform in Action

This Part contains several 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 some particular aspects of different cases that may help illuminate the more general discussion in Parts II and IV of the reform process and how it might be managed.¹¹ Inevitably, a fair amount of the discussion concerns the substance of reform, but in keeping with the thrust of this paper, the main points to be noted are really those related to the management – or lack of it – of the tax reform process.

1. A Planned Comprehensive Approach: Indonesia¹²

Indonesia undertook a major tax reform in the early 1980s. This reform was unique in several ways. First, it was -- as is often recommended but seldom done -- planned well in advance. Second, unlike most tax reforms in developing countries, it was not done in response to an immediate and urgent revenue crisis but rather in anticipation of a likely future revenue need arising from diminishing petroleum revenues. Third, it was considerably more comprehensive in both intention and to some extent reality than most tax reforms in developing countries. Finally, and again rather unusually, it was to a very large extent carried out as originally planned.

As usual, much of the economic 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, first with respect to the way the reform was formulated and then with respect to how it was implemented. Importantly, as Gillis (1985) stresses, 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 politically controversial. The complex issues, Gillis (1985) says, 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 efficacy of tax incentives. And of course every country has its politically controversial tax issues, such as (often) the taxation of civil servants. Issues that have all these characteristics are “impasse issues”, with the potential to affect many aspects of the reform if they are not satisfactorily resolved.

¹¹ Although the facts of the cases are taken largely from the sources mentioned, it should be emphasized that the interpretations are entirely the responsibility of the present author. For other studies of tax reform in particular developing countries, see Gillis (1989), Urrutia et al. (1989), Boskin and McLure (1990) and Thirsk (1997).

¹² This section is based largely on Gillis (1985), Gillis (1989a), Harberger (1989), and Asher (1997).

In the Indonesian reform, the three key “make or break” issues turned out to be, according to Gillis (1985), the appropriate role of tax incentives, the degree of rate progressivity, and, more unusually, the tax treatment of interest income. 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 abolish tax incentives, to have some, but not much, rate progressivity, and also to tax interest fully – although the latter 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 (1997) notes made in the reform were economically desirable, most of the changes were good, and most have lasted. The Indonesian case thus clearly demonstrates that even in a low-income country it is possible to develop and introduce a major tax reform in a relatively short time, to substantially improve the tax system as a result, and to sustain these good results for many years. It can be done.

But how was it done?

- In the first place, and importantly, the tax reform was clearly “owned” by the Indonesians. Although considerable use was made of foreign expertise (hired 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.
- Fourthly, it was originally intended to present the entire reform as a package at the same time in the expectation that this would be an easier political sell than a series of measures. (In fact, however, the major components of the reform – income, sales, and property tax reforms – were 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 (1989, p. 27) concluded that the major lessons to be learned from these

such experiences was simply "...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, as 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.'" 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 issue, however, one of the major problems encountered with 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 real incentive to do so. Indonesia thus offers yet another instance of the truth of the dictum that close attention must always be paid to the administrative dimension of tax reform (Bird, 2003).

Finally, consider the political conditions prevailing in Indonesia at the time of the reform, and indeed until recently. Essentially, Indonesia was a one-party state with a strong and continuing government, not least in the economic sphere. As already mentioned, 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, however, was because no one outside the technical team and the top political leadership really had any opportunity to comment on, or provide input to, 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?

2. Comprehensive Gradualism: Colombia¹³

Perhaps one way to begin to answer the question noted at the end of the preceding section is to consider briefly another country prominent in the lists of "tax reformers" – Colombia. Colombia differs from Indonesia in many ways, but perhaps two differences are 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 was essentially the case in Indonesia. In Colombia, everything is debated in public, often by people who were (say) the last Minister of Finance or who will likely be the next one. Secondly, however, despite this constantly changing set of public sector decision-makers, and the general openness of the policy process, Colombia has, over the years, managed to formulate and implement a surprising number of important tax reforms – reforms again almost entirely "owned" by Colombian policy entrepreneurs, although Colombians have

¹³ This section is based largely on World Bank (1988), McLure (1989), Urrutia (1989), Shome (1995), and McLure and Zodrow (1997).

proved to be very adept at utilizing foreign expertise over the years.

In short, to oversimplify a great deal, Indonesia 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, on the other hand, has a relatively open multi-party system in which a constantly changing technocratic elite argued through in public a series of important tax reforms and, over time, managed to get a surprising number of important changes in place. Neither country perhaps did as much as it could or should have with respect to improving administration in general and in particular did little to ensure that the administration supported policy reforms rather than worked actively to vitiate them.¹⁴ 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 all that much success.¹⁵ Nevertheless, major tax reforms did undoubtedly occur in both countries, although in a very different way.

In contrast to Indonesia's "big bang" in 1983, for example, Colombia had a series of less tax reforms in 1953, 1960, 1974, 1983, 1986, and 1990 (Shome, 1995). 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 again to Indonesia, almost all of these reforms, like most of the many other tax changes that have 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 of reform, and its obvious openness to influence from abroad, it is not surprising that to some extent what it 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 in turn the shifting intellectual dominance of concerns with progressivity and incentives, while the 1986 (and later) reforms reflected much more the 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

¹⁴ As Tanzi (1991, p. 191) notes, for example, 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.

¹⁵ Martinez-Vazquez (2001) notes with respect to Mexico, a country which in some ways combines certain characteristics of Indonesia (one-party state, oil revenues) and Colombia (cultural, geographic), that one of the most striking features of the various tax changes that have taken place over the decades (e.g. Gil Diaz, 1990 and Gil-Diaz and Thirsk, 1997) has been how very little apparent effect they have had on the tax ratio (taxes as percent of GDP), which has remained almost constant. He suggests several possible explanations for this constancy: the reforms in tax structure (1) may have been undermined by unrelated ad hoc measure, or (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 don't stay the same – some people drive faster, and death rates are unchanged.

domestic political concerns, particularly the need to maintain the somewhat fragile but persistent stability of key national political institutions. Perhaps in part because of the overwhelming attention paid to economic and political factors, a continuing characteristic 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 (World Bank, 1988).

In any case, no tax reform in Colombia has ever been, or likely ever will be, either fully comprehensive or expected to be the last word on the matter. Instead, over time, the country's periodic reviews of how this or that aspect of the tax system looks in the light of current thought, have led, piece by piece, to the gradual evolution and adaptation of its tax system to changing circumstances. No great revolutionary package was ever proposed, or implemented. Instead, incrementally, bit by bit, Colombia's system gradually 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 (1997) drew the following lessons from Colombia's experience:

- Tax reform requires a long gestation period. Major changes (e.g. 1974) followed over five years of discussion and development subsequent to a major tax reform report. Ideas were thus 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.
- Tax reform studies serve an important educational purpose and should be widely disseminated. One reason that ideas lived on in Colombia is because they were published, taught in universities, and widely discussed, thus in part shaping the agenda for future policy.¹⁶
- Reforms occur when countries can no longer put them off. (Of course, as mentioned above, the Indonesian case offers a counterexample.)
- 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 have to pay themselves for advice often appear to value it at what they paid

¹⁶ This is consistent with the advice of Shoup (1991) but of course quite contrary to what was done in Indonesia (Asher, 1997) or, indeed, the practice followed by the IMF (Tanzi, 1994).

3. Transitional Approaches: Poland and Belarus¹⁷

In a recent review of experience with tax reform in transitional countries, Martinez-Vazquez and McNab (2000) draw a number of interesting lessons;

- For example, they stress that where a country ends up, and how fast it gets there, depends to a considerable extent on where it starts: initial conditions matter, a lot.
- Second, they argue that too many rapid incremental crisis-driven changes in the absence of any comprehensive strategy gave rise to many avoidable costs, not least because of the continued “interventionist” nature of policy (tax incentives, etc.) and that a more deliberate approach allowed for more consensus building and successful reform.
- Third, they emphasize that those reforms were most successful which were accompanied by complementary reforms in such critical areas as accounting and legal systems, tax administration, and intergovernmental fiscal relations.

The cases discussed in this section 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, as revenues continue to shrink more quickly than expenditures, and little relief seems in sight. Moreover, some measures taken in some transitional countries 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, will exacerbate the already considerable disincentives in many such economies to the expansion of legitimate private enterprise and results in still further expansion of the underground economy. Such possible alternatives as financing deficits by recourse to such non-conventional (or implicit) taxes as inflation, seignorage, financial repression, and the like, although they may be politically attractive in the short run, will also often make things worse in the long run.

In their short fiscal history since emerging from the 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

¹⁷ This section is based on Bird (1999).

process.¹⁸ Instead, the tax systems now in place in many transitional countries often appear 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, as noted by Martinez-Vazquez and McNab (2000). 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 revenues may hinder long- term reform goals.
- Another reason may be the persistence of political and bureaucratic tendencies to “over-plan” private investment through excessive use of incentives. The “inertia” of fiscal institutions mentioned above with respect to Colombia is a phenomenon found much more generally.
- A third reason may be that inadequate time and attention has generally been devoted to the creation of a tax administration capable of coping with the difficult circumstances facing transitional countries.

These points may be illustrated by reference to the experience of two transitional countries in the first half of the 1990s — Poland, one of the leaders of the process, and Belarus, one of the laggards. World Bank (1996) 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. Private sector output accounted for close to 60 per cent of Poland’s GDP in 1995; the comparable figure in Belarus was little more than 10 per cent — or less than most Central Asian republics. Although neither Poland nor Belarus is necessarily representative of transitional countries as a whole, it may thus not be too misleading to consider them as representing two extremes of the transitional process.

Poland

The Polish 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 reform : the basic structure of the Polish tax system was altered substantially to fit better the new market-oriented reality of the Polish economy.

¹⁸ As noted in Part II above, McIntyre and Oldman (1975) cited the need for such flexibility as one of the key aspects of managing tax reform successfully.

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 tax payers, 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 must be faced in transitional economies. The first problem is the need to shift from taxing enterprises to taxing households. The second, somewhat contradictory, problem is 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 had 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 6-8 per cent of GDP in 1992-93 — most of which came from wage-related income, including pensions — which represented a substantial increase over the 3-4 per cent 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 per cent of GDP in 1990 to little more than 4 per cent 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 is 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 4-5 per cent 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 a compensating increase 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 per cent PIT rate — the rate applicable at the time to over 90 per cent 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 suggested, but in terms of tax administration there was indeed a major change in how enterprise profits 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 structural features of the PIT law (notably housing reliefs and the provision for joint filing). Although 80 per cent 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, dramatic and in many ways successful as Poland's introduction of VAT in 1993 was, the fact remains that in 1994, as in pre-reform years, almost half of domestic VAT receipts 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 surcharge), in total less than 10 per cent 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 the VAT Poland collected 5-6 per cent of GDP in the form of “turnover taxes” on domestic firms (excluding ATF products). Immediately after the introduction of VAT, it collected only about 1-2 per cent (net) of GDP from these firms (or those that have replaced them). In part, of course, this decline reflected the extent to which taxes were — quite correctly from an economic perspective¹⁹ — removed from intermediate goods and exports owing to the introduction of the 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 administration 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 the tax reform in Poland was thus rather paradoxical. On one hand, most revenue was still collected from essentially the same sources as before 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 tax reform proposals.²⁰

Belarus

In contrast to the experience of Poland, 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 been saved from some of the dangers and costs of transition by the very slowness of its move away from the pattern of the command economy.

Of course, the price of such gradualism is that not much has been done. Significant problems remain to be resolved with respect to taxation in Belarus. The very fact

¹⁹ “Untaxing” intermediate goods is of course a central conclusion from the optimal tax literature.

²⁰ For further discussion of the Polish case, see Bird (2003).

that Belarus has kept so closely to the old system may over time, however, give rise to increasing problems for tax administration, increased compliance costs for enterprise, 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 current tax structure will become 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.²¹

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” — as well. In particular, many (e.g. Gillis, 1989b) have argued that a broad-based consumption tax — usually the VAT — is a much sounder basis for tax reform than a broad-based personal income tax.

In principle, a 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 lies at the heart of the VAT (and, for that matter, the profits tax). Determining such costs is a complex process, prone to error and manipulation. This approach may have worked well when prices were stable and pre-determined, and all the tax system essentially did was channel some enterprise revenues into budgetary accounts. But it is not satisfactory now, and it will become even less appropriate as and when Belarus moves further down the transitional road. Given this bad tax design, computerizing the existing complex and unsatisfactory procedures, as some outside advisers suggested, seemed likely to delay the essential task of training tax officials who can audit the books of tax payers in a more meaningful way than the essentially mechanical “verification” process in use. Improving the administration of a fundamentally bad tax is not necessarily an improvement.

Before attempting to adapt the tax administration to the tax system, more attention should be paid to ensuring that the system — both the tax structure and basic tax procedures — is itself compatible with a modern economy. One path to doing so -- although neither an easy nor a tranquil path in any country -- 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

²¹ As noted earlier, Indonesia is the classic case of a country that consciously chose this strategy in the early 1980s. As Bird and Chen (1998) note, however, by the end of the 1990s, Indonesia appeared to impose one of the highest marginal effective tax rates on foreign investors in Asia.

developing countries, remain far from this ideal, with little “reality checking” being applied to the countless proposals for special tax reliefs and incentives that too often constitute public discussion of tax matters.

IV. 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. Time and space do not permit either reproducing or synthesizing all that people think they have learned about how to manage the tax reform process in developing countries. Nonetheless, a useful way to begin to wrap up this wide-ranging discussion may be to set out a few of the many “rules for reformers” that can be found in a selection of the large relevant literature.

In an interesting early analysis, for example, Forte and Peacock (1981) explored some of the implications for tax reform of an analysis by Breton (1974) of the many ways in which citizens can influence policy outcomes other than simply voting periodically for this or that politician or political party. They 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 legislation 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 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 their assets from the taxing jurisdiction.

As Musgrave (1980) discusses, the way in which those who wish to influence tax policy organize to do so can seldom be fit neatly into such neat aggregate economic categories as “capital” and “labor.” Income groups – the “rich” and the “poor” – may come a bit closer but are again likely to be far too aggregative. Interests may vary by age, by region, by source of income, and in many other ways, and different people may, for different purposes, fall into a number of different overlapping groups. An employed homeowner living in a particular city, for example, has some things in common with a self-employed homeowner, and others in common with an employed tenant. 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 (carrying different costs) to influence the final policy outcome. All this matters a lot because in the end what determines whether any particular tax change is made is invariably in the end a political calculation by those in a position to make the decision as to the relative costs and benefits of action (or inaction).²²

²² See Hettich and Winer (1999) for an important study along these lines, and Gillespie (1991) for an application of this general framework to the case of Canadian federal tax policy.

Such analysis suggests 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, resulting in sufficient political unrest to lead to major modification of many aspects of the reform.²³ On the other hand, a reform can also encounter severe difficulty if just one component of it is seen to affect very adversely some small but sufficiently powerful group, such as senior civil servants in Jamaica or policemen in Bolivia. There is, as it were, a “market” for tax reform, and as all who have actually been in the business of “selling” such reforms soon learn, it is essential to create sufficient political demand for change, if change is to become a reality.

As Nerré (2001) argues, 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 are, in one way or another, 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.

1. Lessons from Experience in Developed Countries

Tax reform is, of course, not much, if at all, easier in developed countries than in developing countries. Unsurprisingly, given the preponderance of scholarly activity in developed countries, there is a large literature analyzing from various perspectives the apparent factors leading to success or failure in tax reform efforts in such countries. One small example will have to suffice here. In an interesting little book entitled “Successful Tax Reform”, Sandford (1993), defining 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:²⁴

- The essential requirement for success is a strong political will exemplified by a champion (or champions) prepared to put their reputation on the line.²⁵

²³ The story is told in Gillespie (1991) who, interestingly, nonetheless sees the outcome as something of a success in that the government was, in his view, able, by including a variety of unpopular proposals in the reform package, to “flush out” a lot of political opposition to particular proposals from disparate groups thus preventing opposition concentration on the most important revenue measure (de-indexing the income tax), which was therefore successfully implemented. Others (e.g. McQuaig, 1987, St.-Hilaire and Whalley, 1985) present this episode quite differently, as a major reform attempt that failed. For good discussions of the tax reform process in Canada in general, see Good (1980) and Hartle (1988).

²⁴ Even leaving aside the huge U.S. literature, interesting examples of other approaches include such major studies as Boskin and McLure (1990), Rose and Karran (1987), Messere (1993), Peters (1991), and Steinmo (1993).

²⁵ Bahl (2002) has 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. As Petrie (1998) stresses (in an interesting study of a major social policy reform in New Zealand), however, a champion may not be enough for sustainability. Without a catalytic personality – someone with a clear

- The champion must be strongly supported by the chief executive.
- 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 hocery*.
- 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” (Roger Douglas, quoted in Sandford (1993), p. 203).
- 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” (p. 208).²⁶
- 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 policy-making, drawing on private sector expertise, developing a good program of education and guidance using all available media, and consolidating one reform before attempting another.²⁷

2. Lessons from Experience in Developing Countries

A few years earlier, Gillis (1989b) summed up the lessons he drew from a similar major review of tax reform episodes in a number of developing countries as follows:

- Hurried reforms usually fail. 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.²⁸ (On the other hand, he also notes that reforms that lose money are unlikely to achieve any other objective either.)
- 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.²⁹

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.

²⁶ For a useful discussion of some Canadian examples of how *not* to have consultation about tax reform, see Hartle (1988).

²⁷ Sandford (1993), 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 UK (Robinson and Sandford, 1983) and his later reprise of the tax reform issue in Sandford (2000). The last few sentences of the latter book deserve 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’ ” (p. 196).

²⁸ For a different view, see McLure and Zodrow (1997) and the Colombia case discussed in Part III above.

²⁹ No one has made this point more clearly than Radian (1979); see also Radian and Sharkansky (1979).

- More successful reforms pay much more attention to implementation issues such as legal drafting, training officials, and even the design of new forms.
- Continuity among decision-makers responsible for tax policy and implementation helps success, especially of more comprehensive reforms.
- Good reforms do not depend on “gimmicks” such as presumptive taxes and lotteries.
- How tax reforms are sequenced with other reforms matters, but it is not clear what sequence is best for success.
- It is also not clear if an incremental or a comprehensive approach to tax reform is best.

Interestingly, Gillis (1989b) concludes 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 cautions that it is not clear if the experience of these countries tells us anything about prospects in low-income countries. (p. 517)

Around the same time as the Gillis paper, Carl Shoup (1991), one of the pioneer foreign tax advisors of the post-World War II era, summarized what he had learned in his extensive experience of how to organize such missions³⁰ by distinguishing between tax architecture, tax engineering, and tax administration. By “tax architecture” he saw as the design of the key features of each tax and the tax structure as a whole. “Tax engineering”, on the other hand, he thought of 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, his argument was that “tax engineering” – the design of the details -- was likely to be the area in which foreign expertise could be most fruitful, and that this was a task in which lawyers and accountants could often be more helpful than economists. Interestingly, Shoup (1991) also noted sociologists, social psychologists, and political scientists could also contribute usefully to tax missions both in fitting the “tax engineering” to the environment and in understanding the political setting.³¹

3. Lessons from Bank and Fund Experience

Although by far the greater proportions of the extensive work sponsored by 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. World Bank (1991), for examples, summarizes the main lessons learned from Bank experience with tax reform in developing countries up to the end of the 1980s. The principal lessons with respect to the process of tax reform are said to be several:

³⁰ For a useful review of the various missions led by Shoup, see Gillis (1991).

³¹ Somewhat curiously, Shoup does not discuss what some observers (e.g. Gillis, 1991) have seen as the major contribution of his 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.

- 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” (p. 44).
- 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.
- Tax reform must take carefully into account the initial conditions of the country, such as its constitution and its “tax culture.”³²
- For tax reform to succeed, there must be domestic ownership of the proposals.
- 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, Thirsk (1997a) similarly devoted a few pages to the “how.” Specifically, he made the following points:

- 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.
- Successful reform requires a cadre of policy-makers and experts who have detailed knowledge of and involvement with the existing system and who take responsibility for the reform.
- Substantial efforts must be made to educate both the tax administration and the public and to get the public “on board” supporting the reform.
- Good tax reform cannot be carried out in isolation: it requires both good tax administration and good expenditure policy, or it is unlikely to be sustainable.

Far more than the Bank, for many years, the Fiscal Affairs Department of the International Monetary Fund has been the major international player in the tax reform game. It is thus of special interest to consider finally what it 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 we can gain some small idea of its evolving ideas by considering briefly a few of the many writings of its two long-term heads, Richard Goode and Vito Tanzi.

Shortly after Goode retired after almost 20 years as head of FAD, he wrote an interesting book on Government Finance in Developing Countries (1984), in the last chapter of which he offered some general advice on how to make policies “effective and efficient.” What he says there may be summed up in a few key propositions:

³² For a recent discussion of this concept, see Nerré (2001).

- Policies must be formulated clearly and realistically. Incremental change may lead to missing big needed changes but puts less demand on scarce policy-making, administrative, and compliance resources, and is hence more likely to succeed. Overly ingenious devices, and undue reliance on discretionary administration are to be avoided.
- Much more attention to organization, management and procedures is needed if policy initiatives are to be successful.
- Corruption is a plague and should be prevented as much as possible by making laws simpler and reducing administrative discretion.
- Big changes can be made only occasionally, when circumstances are right, so 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 government.

Subsequently, Goode (1987) reflected further on why so many proposals for tax reform, perhaps especially those by visiting experts, were so seldom implemented. He identified several possible reasons -- inadequate information for 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 of reform, which was as a rule 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 what was important was to make sure that such changes were worthwhile ones.

While Vito Tanzi has written even more extensively about such matters³³, we shall consider here only some remarks in a recent review paper (Tanzi and Zee, 2000) which for the most part focuses on substantive issues. Before getting into all the things that developing countries should be doing, however, Tanzi and Zee (2000) note, as did Goode (1987), 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, they say, are “less amenable to rational tax policy than in advanced countries” (p.299). Although they do not explore the political aspect in depth, it appears that what they have mainly in mind is the highly unequal income distributions 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 do not discuss this – have most to lose and least to gain by expanding state revenues.³⁴

³³ For a useful collection of his writings, see Tanzi (1991).

³⁴ This important argument has been discussed recently by Lledo, Schneider and Moore (2003) in a paper focusing on Latin America, the region of the world in which income inequality is perhaps most marked.. These authors stress 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” (p.47). In such circumstances, is meaningful tax reform likely?” For further discussion, see also Bird (2003).

One last example may perhaps be related to this point. In concluding an interesting set of case studies of reforms in six countries, Urrutia and Yukawa (1989) stressed that, while there is no evidence that reform was more or less likely to succeed under a democratic or authoritarian regime, all successful cases seemed 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 Part III). 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.

V. Conclusion

Finally, by way of conclusion, consider the following brief summary presentation of a few of the major questions would-be reformers need to consider that seem to emerge from this compilation of views and approaches to tax reform in developing countries:

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 try 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” answer to such questions, of course, can only be determined for a particular country at a particular time. More importantly, it 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.

Some years ago, Bird (1977) suggested some “rules for reformers” in the form of what may be called the “three R’s” of good reform -- robustness, resiliency, and relevancy. As Gillis (1985), McIntyre and Oldman (1975) and many others have stressed, good planning and policy formulation that focuses on what matters and what can be done and pays close attention to detail and implementation is the key to “relevance.” As McIntyre and Oldman (1975), McLure and Zodrow (1997) and others have argued, building up adequate institutional capacity in the tax field, both inside and outside government, is the key to being able to adapt policies to changing circumstances and needs, thus ensuring both robustness and resiliency. But as any consideration of actual tax reform experience demonstrates, the best planning and the best implementation team in the world will not produce useful results unless there is 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 the “civic society.” Even the best product will not sell unless it is properly marketed. In the end, therefore, tax reform is always and everywhere an exercise in practical politics.

References

- Ehtisham Ahmad and Nicholas Stern (1991) *The Theory and Practice of Tax Reform in Developing Countries* (Cambridge: Cambridge University Press).
- Mukul Asher (1997) "Reforming the Tax System in Indonesia," in Thirsk (1997).
- Roy W. Bahl (2002) "Implementation Rules for Fiscal Decentralization," in M. Govinda Rao, ed., *Development, Poverty, and Fiscal Policy* (New Delhi: Oxford University Press).
- Richard M. Bird (1977) "Tax Reform and Tax Design in Developing Countries," *Rivista di diritto finanziario e scienza delle finanze*, 36 (No.2): 297-306.
- Richard M. Bird (1999) "Tax Policy and Tax Administration in Transitional Countries," in G. Lindencrona, S-O. Lodin, and B. Wiman, eds., *International Studies in Taxation Law and Economics* (London: Kluwer Law International).
- Richard M. Bird (2003) "Taxation in Latin America: The Balance between Equity, Efficiency and Sustainability," Paper prepared for World Bank, April.
- Richard M. Bird (2003a) "The Administrative Dimension of Tax Reform," Paper prepared for World Bank, April.
- Richard M. Bird and Duanjie Chen (1998) "The Fiscal Framework for Business in Asia," in Wendy Dobson, ed., *Fiscal Frameworks and Financial Systems in East Asia: How Much Do They Matter?* (Toronto: University of Toronto Press).
- Michael J. Boskin and Charles E. McLure, Jr. (1990) *World Tax Reform: Case Studies of Developed and Developing Countries* (San Francisco CA: ICS Press).
- Albert Breton (1974) *The Economics of Representative Government* (Chicago: Aldine).
- Albert Breton (1996) *Competitive Governments* (Cambridge: Cambridge University Press).
- Francisco Forte and Alan Peacock (1981) "Tax Planning, Tax Analysis, and Tax Policy," in Alan Peacock and Francesco Forte, eds., *The Political Economy of Taxation* (Oxford: Basil Blackwell).
- Francisco Gil-Diaz (1990) "Tax Reform Issues in Mexico," in Boskin and McLure (1990).
- Francisco Gil-Diaz and Wayne Thirsk (1997) "Mexico's Protracted Tax Reform," in Thirsk (1997).

- W. Irwin Gillespie (1991) *Tax, Borrow and Spend : Financing Federal Spending in Canada, 1867-1990* (Ottawa : Carleton University Press).
- Malcolm Gillis (1985) "Micro- and Macroeconomics of Tax Reform: Indonesia," *Journal of Development Economics*, 19: 221-54.
- Malcolm Gillis, ed. (1989) *Tax Reform in Developing Countries* (Durham NC: Duke University Press).
- Malcolm Gillis (1989a) "Comprehensive Tax Reform: The Indonesian Experience, 1981-1988," in Gillis (1989).
- Malcolm Gillis (1989b) "Tax Reform: Lessons from Postwar Experience in Developing Nations," in Gillis (1989).
- Malcolm Gillis (1991) "Legacies from the Shoup Tax Missions: Asia, Africa, and Latin America," in Lorraine Eden, ed., *Retrospectives on Public Finance* (Durham NC: Duke University Press).
- David A. Good (1980) *The Politics of Anticipation: Making Canadian Federal Tax Policy* (Ottawa: School of Public Administration, Carleton University).
- Richard Goode (1984) *Government Finance in Developing Countries* (Washington: Brookings Institution).
- Richard Goode (1987) "Obstacles to Tax Reform in Developing Countries," in H.M. van der Kar and B.L. Wolfe, eds., *The Relevance of Public Finance for Policy-Making* (Detroit: Wayne State University Press).
- W. Gorbachuk (2002) "Political Economy of Tax Reform in Ukraine, 1998-2001." Paper prepared for World Bank, April.
- Arnold C. Harberger (1989) "Lessons of Tax Reform from the Experiences of Uruguay, Indonesia, and Chile," in Gillis (1989).
- Douglas G. Hartle (1988) "Some Analytical, Political and Normative Lessons from Carter," in W. Neil Brooks, ed., *The Quest for Tax Reform: The Royal Commission on Taxation Twenty Years Later* (Toronto: Carswell).
- Walter Hettich and Stanley Winer (1985) "Blueprints and Pathways: The Shifting Foundations of Tax Reform," *National Tax Journal*, 38 (December): 423-46.
- Walter Hettich and Stanley L. Winer (1999) *Democratic Choice and Taxation* (Cambridge UK: Cambridge University Press).

- Albert O. Hirschman (1963) *Journeys Toward Progress: Studies of Economic Policymaking in Latin America* (New York: Twentieth Century Fund).
- Victor Lledo, Aaron Schneider, and Mick Moore (2003) “Pro-poor Tax Reform in Latin America: A Critical Survey and Policy Recommendations,” Institute of Development Studies, University of Sussex, March.
- Jorge Martinez-Vazquez (2001) “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.
- Jorge Martinez-Vazquez and Robert M. McNab (2000) “The Tax Reform Experiment in Transitional Countries,” *National Tax Journal*, 53 (June): 273-98.
- Michael J. McIntyre and Oliver Oldman (1975) *Institutionalizing the Process of Tax Reform: A Comparative Analysis* (Amsterdam: International Bureau of Fiscal Documentation).
- Charles E. McLure, Jr. (1989) « Analysis and Reform of the Colombian Tax System, » in Gillis (1989).
- Charles E. McLure, Jr. and George Zodrow (1997) « Thirty Years of Tax Reform in Colombia, » in Thirsk (1997).
- Linda McQuaig (1987) *Behind Closed Doors: How the Rich Won Control of Canada's Tax System* (Markham ON: Penguin Books Canada).
- Ken Messere (1993) *Tax Policy in OECD Countries* (Amsterdam: IBFD Publications).
- Richard A. Musgrave (1980) “Theories of Fiscal Crisis: An Essay in Fiscal Sociology,” in Henry J. Aaron and Michael J. Boskin, eds., *The Economics of Taxation* (Washington: The Brookings Institution).
- Birger Nerre (2001) “The Concept of Tax Culture,” in National Tax Association, *Proceedings 94th Annual Conference*.
- David Newbery and Nicholas Stern, eds.,(1987) *The Theory of Taxation for Developing Countries* (New York: Published for the World Bank by Oxford University Press).
- B. Guy Peters (1991) *The Politics of Taxation: A Comparative Perspective* (Cambridge MA: Blackwell).
- Murray Petrie (1998) *Organisational Transformation: The Income Support Experience* (Wellington NZ: Department of Social Policy).

Alex Radian (1979) "On the Differences between the Political Economy of Introducing and Implementing Tax Reforms: Israel 1975-1978,": *Journal of Public Economics*, 11: 261-71.

Alex Radian and Ira Sharkansky (1979) "Tax Reform in Israel: Partial Implementation of Ambitious Goals," *Policy Analysis*, 5: 351-66.

Ann Robinson and Cedric Sandford (1983) *Tax Policy-Making in the United Kingdom* (London: Heinemann Educational Books).

Richard Rose and Terence Karran (1987) *Taxation by Political Inertia* (London: Allen and Unwin).

Cedric Sandford (2000) *Why Tax Systems Differ: A Comparative Study of the Political Economy of Taxation* (Bath UK: Fiscal Publications).

Cedric Sandford, ed. (1993) *Successful Tax Reform: Lessons from an Analysis of Tax Reform in Six Countries* (Bath UK: Fiscal Publications)

Partasarathi Shome, ed. (1995) *Comprehensive Tax Reform: The Colombian Experience* (Washington: International Monetary Fund).

Carl S. Shoup (1991) "Melding Architecture and Engineering: A Personal Retrospective on Designing Tax Systems," in Lorraine Eden, ed., *Retrospectives on Public Finance* (Durham NC: Duke University Press).

Richard Snyder and David Samuels (2001) "Devaluing the Vote in Latin America," *Journal of Democracy*, 12 (January): 146-59.

France St.-Hilaire and John Whalley (1985) "Reforming Taxes: Some Problems of Implementation," in David Laidler, ed., *Approaches to Economic Well-Being* (Toronto: University of Toronto Press).

Sven Steinmo (1993) *Taxation and Democracy: Swedish, British and American Approaches to Financing the Modern State* (New Haven: Yale University Press).

Vito Tanzi (1991) *Public Finance in Developing Countries* (Cheltenham UK: Edward Elgar).

Vito Tanzi (1994) "The IMF and Tax Reform," in Amaresh Bagchi and Nicholas Stern, eds., *Tax Policy and Planning in Developing Countries* (New Delhi: Oxford University Press).

Vito Tanzi and Howell H. Zee (2000) "Tax Policy for Emerging Markets: Developing Countries," *National Tax Journal*, 53 (June): 299-328.

Wayne Thirsk, ed. (1997) *Tax Reform in Developing Countries* (Washington: World Bank).

Wayne Thirsk (1997a) "Overview: The Substance and Process of Tax Reform in Eight Developing Countries," in Thirsk (1997).

Miguel Urrutia (1989) "The Politics of Fiscal Policy in Colombia," in Urrutia et al. (1989).

Miguel Urrutia and Setsuko Yukawa (1989) "Economic Growth, Fiscal Policy and Democracy," in Urrutia et al. (1989).

Miguel Urrutia, Shinichi Ichimura, and Setsuko Yukawa, eds. (1989) *The Political Economy of Fiscal Policy* (Tokyo: United Nations University).

World Bank (1988) *World Development Report 1988* (Washington).

World Bank (1991) *Lessons of Tax Reform* (Washington).

World Bank (1996) *World Development Report 1996* (Washington)

Angel Q. Yoingco (1969) "Tax Policy Planning and Administration: The Philippine Experience," *Economic Research Journal*, 16 (December): 124-39.

Angel Q. Yoingco (1976) "Tax Research: The Philippine Experience," Graduate School, Centro Escolar University, Manila, March.