Tax Reform in Selected Countries of Latin America and East Asia: A Ccomparative View

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1. Introduction

Tax reform is becoming an important issue for government all over the world. In developing as well as in developed countries we observe a common trend in reforming the tax systems. This general trend comprises a move towards the reduction of trade taxes and trade liberalization and, through the widespread use of value-added taxes, an increasing emphasis on production and consumption taxes. Furthermore, we discern a movement toward the reduction of personal tax rates and the consolidation of the number of brackets. Finally, most of the reforms encourage reductions in corporate tax rates and grant incentives to attract foreign direct investment. Such a package is by now largely applied by countries that have reformed their tax systems. Moreover, there is a clear recognition that the objectives of macroeconomic stability and fiscal equilibrium are closely linked and mutually reinforced. It is difficult to achieve such stability without deeply adjusting the public finances. Fiscal adjustment is thus considered a key component of stability programs and, within it, tax policy plays a critical role. On the other hand, macroeconomic conditions strongly influences the process of tax reform. Hence, it ceased to be a long-term issue and is becoming a short-term concern. Tax reforms are also seen as an essential complement to industrial and trade policies. Indeed, a tax system heavily focused on trade taxes is no longer compatible with the new orientation of trade policies clearly, directed towards a higher degree of openness. Finally,

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administrative reforms are necessary in all countries that aspire to have a satisfactory tax system. In many countries administrative weaknesses and evasion constitute serious problems for the effectiveness of reform. This is why tax administration has, recently, constituted a major component of tax reform.

In such a context, Latin America and East Asia are no exceptions. Tax reform in both regions, adopted the basic features of the above mentioned tendencies. Yet, we find differences in patterns of reform across regions. For instance, emphasis on equity goals was, clearly, a typical characteristic of Latin American reforms whereas in East Asia such a preoc-cupation played a secondary role. Also, the way reforms were implemented differed among the regions analyzed. In particular, differences where found concerning the persistence and stability of reforms. Finally, indexation is a typical characteristic that distinguishes Latin American tax reforms from those undertaken in East Asia. By now, many countries in the former region have introduced some kind of inflation-adjustment to their tax system whereas in East Asia such an adjustment is not widespread. This is hardly surprising since, historically, inflation rates have been much higher in Latin America than in East Asia.

Therefore, the divergence between the patterns of reform across the two regions deserves to be investigated. The objective of this paper is to analyze the experiences of tax reforms in Latin America and East Asia from a comparative perspective. The paper examines the impact of reform on tax structures and income distribution by trying to identify the elements responsible for the effectiveness of tax reforms in both regions. As significant differences are expected to be found across regions, the soundness and stability of reforms will also be analyzed. Finally, selected experiences of reform will be concisely discussed.

This paper is organized as follows. Section 2 discusses the impact of tax reforms on tax structures. Section 3 reviews the administrative aspects of reform. Section 4 analyses the relation between tax reforms and income distribution. Section 5 discusses the link between political and macroeconomic stability, on one side, and the effectiveness of reforms on other. Section 6 briefly discusses selected reforms in Latin America and East Asia and Section 7 summarizes the main conclusions.

2. Impact of Reform on Tax Structures

Tax policy plays a key role on resource allocation, mainly through its impacts on relative prices. It influences labor-supply effort and creates incentives to save and invest. Thus, it is important to identify patterns of reforms that would minimize the welfare cost of taxation. Optimal-tax theories provide rules for designing such tax structures. They endorse a pattern of differentiated taxation and rarely recommend uniform taxation. Their main weakness comes from the fact that they are difficult to apply, partly because they depend crucially on the availability of good elasticity estimates. Moreover, the efficiency and vertical equity arguments which are part of the theory of optimal tax reform are difficult to be understood and thus to be politically supported. Finally, as optimal tax theory usually does not incorporate costs of tax administration and compliance it provides only a few useful guidelines for reforming tax systems.

Since optimality in real world is rarely attained, recent tax reforms are increasingly becoming directed toward the achievement of greater neutrality in taxation by relying on more uniform tax rates. Although, from a strictly welfare perspective, uniform taxes are only advisable in special cases, they have a strong political, economic and administrative appeal. In parti-cular, uniform taxation is easier to enforce and minimizes rent-seeking behavior. Modern proposals for reform clearly demons-trate strong preferences for base-broadening and aversion to exemptions and tax preferences (except those needed for distributive purposes). Hence, emphasis on neutrality and greater uniformity is a key features of contemporaneous tax reforms.

In this context, the relevant question is to what extent recent changes in tax systems in Latin America and East Asia followed those prescriptions. A number of angles deserve to be examined, such as, How significant is the degree of tax dif-ferentiation and which rationale is behind the setting of tax rates? Could we identify in Latin America a clear tendency towards the utilization of tax systems excessively differentiated with East Asia presenting a lower dispersion of tax rates? Is Latin America systematically more protected than East Asia, and has this point been taken into account in the designing of taxes? The rest of this section tries to provide answers to these questions.

2.1 Reform of Consumption Taxation

Recent changes in consumption taxation have two main characteristics. First, the replacement of turnover taxes for the more modern value-added taxes has probably constituted the most important element of innovation in many reforms. Second, the move towards greater trade liberalization is associated with the most important tax packages. At the same time, recent reforms seem to point towards an increasing specialization of tax instruments. In particular, value-added taxes are intended to raise revenue and so--at least in theory--they should be kept as simple as possible, while excises are supposed to add an element of progressivity to taxation of goods and services. Tariffs are being used for protective purpose rather than revenue raising even if for small countries trade taxes continue to be an importance source of revenue. Below we will analyze the role of VAT and trade taxes on reforms in Latin America and East Asia.

2.1.1 Value Added Taxes

The value added tax is by now adopted by about one hundred nations. All over the world, the replacement of the old and cascading sales taxes by the VAT represented a clear advance of the modern tax systems. The introduction of this tax has constituted one of the crucial elements for successful tax reforms. In the last generation, almost every episode of comprehensive tax reform has involved the adoption of a VAT[2].

Latin America and East Asia also followed this pattern. By now, the VAT is widespread in both regions. Table 1 shows the date of introduction and the position in mid 1995 of the rate structure of value-added taxes in Latin America and East Asia. The first obvious comment is that, as a rule, the value-added tax was

[2] One of the exceptions is the successful 1974 Colombian reform which emphasized income taxation.

introduced in Latin America much early than in East Asia. Brazil was the first country to introduce this type of taxation[3]. Among the different types of VAT taxes, the one based on the invoice methods were introduced in Latin America in the late 1960s, and have been adopted by West European and developing countries. Only very recently, the East Asian countries adopted a VAT. Except for Korea, which adopted the VAT in 1977, East Asian countries introduced this tax during the late 1980s and in the 1990s. The last among the surveyed countries to adopt the VAT was Singapore, in 1994.

Comparing VAT rates one notes that rates are consistently higher and more differentiated in Latin America than in East Asia. From inception, the rate structure was much more differentiated within the former region. Of course, this may reflect the fact that the latecomers benefit from the experience--including the mistakes--of the pioneers. Thus, East Asia tends to follow the international trend that calls for moderate rates applied to a broad base. There is also a tendency in that region to adopt more uniform rates. In Latin America, multiple rate structure seems to be the political price which was paid for raising the basic VAT rate above 10 percent.

Equity considerations may also partly explain the differentiation and the great number of exemptions that characterizes the VAT structure in Latin America. The more non-egalitarian income distribution in Latin America, together with a lack of a comprehensive income tax and transfer system, led to the use of indirect taxes as an instrument for redistribution.[4] East Asia, with a better income distribution, thus having no pressing need to emphasize equity considerations, was able to prioritize efficiency aspects of the indirect tax system. Yet, it should be noticed that if a VAT is riddled with many rates and exemptions it may not offer many advantages over a turnovert

[3] This country was the world pioneer in implementing value-added tax (through the retail level) in January, 1967. Denmark closely followed Brazil by introducing the VAT in July of the same year. Indeed, this tax was first enacted for Japanese prefectures in 1950 but was never implemented (see Gillis(1989)).
[4] Indeed, exempting basic commodities could make a significant contri-bution to the progressivity of the indirect tax system (Bird (1987)).

Table 1

Value Added Tax Rates in Latin America and East Asia[1]

Countries	VAT Introduction Date	At Introduction	July 1995
Latin America			
- Argentina	Jan. 1975	16	21[2], 27
- Bolivia	Oct. 1973	5,10,15	14.92[3]
- Brazil[4]	Jan. 1967	15	9, 11
- Brazil[5]	Jan. 1967	15	17
- Chile	Mar. 1975	8, 20	18
- Colombia	Jan. 1975	4, 6,10	8,14,15[6]
- Mexico	Jan. 1980	10	15,10[7]
- Peru	Jul. 1976	3, 20, 40	18[8]
- Uruguay	Jan. 1968	5,14	14, 23
- Venezuela	Oct. 1993	10	10, 12.5, 20[9]
East Asia			
- Indonesia	Apr. 1985	10	10, 20, 35
- Korea	Jul. 1977	10	2, 3, 5,10
- Philippines	Jan.1988	10	10
- Singapore	Apr. 1994	3	-
- Taiwan	Apr. 1986	5	5,15,25
- Thailand	Jan. 1992	7	7

Source: Alan A. Tait, IMF/FAD

1: Rates shown in **bold type** are the so called effective standard rates(tax exclusive) applied to goods and services not covered by other specially high or low taxes; 2. In force for one year starting on April 1st, 1995; supplementary VAT rates of 8 and 9 percent on non capital imports; 3. Effective rate; legislated rate is 13 percent; 4. On interstate transactions depending on region; 5. On intrastate transactions; 6. The 15 percent rate is applied to insurance acquired abroad to cover goods, transportation risks, ships, aircrafts and vehicles registered in the country, provided this service is not encumbered in the country of origin; 7. Starting on April 1st, 1995, the general rate is maintained at 10 percent in border areas, except in the sale of real state which is subject to 15 percent; 8. The 18 percent rate includes a 2 percent rate of the Municipal Promotion Tax; 9. Venezuela applies additional rates of 10 percent and 20 percent on the consumption of luxury goods.

Latin America is by now running against the international tendency of reducing rates and broadening the tax base. Indeed, except for Peru and Chile, Latin American countries increased the basic VAT rate between the introduction date and July 1995. Such increases may have been prompted by the need to increase tax revenues corroded by a high rate of base erosion due to evasion and a plethora of tax privileges and exemptions.

In most countries of both regions, the value-added tax functions also as an incentive to trade. Exports and capital goods are usually excluded from the base of this tax. By not exporting taxes and by facilitating the transfer of technology, these countries are able to improve their competitivity in international markets[5].

2.1.2 Trade Taxes

As previously stated, reforming trade taxes is a natural complement to industrial and trade policies. The recent opening of developing countries to international trade and investment created further constraints to tax options and pressed the governments to adapt their tax policies. In particular, there is a clear signaling that tax systems heavily based on trade taxes are difficult to be sustained in the long run and therefore should be revised. This section examines to what extent reforms in East Asia and Latin America took into account these considerations. When comparing those regions two questions stand out: First, is Latin America effectively more protected than East Asia so that the scope for reform is much broader in that region? Second, does Latin America present a higher degree of tax rates dispersion so that reform should aim at a greater uniformit

[5] An exception is Colombia, whose VAT is close to a GNP type where capital goods are only partly exempt.

Table 2
Selected Indicators of Trade Openness in Latin America and East Asia

Countries	Year of Opening	Average Tariff	Quota Average	Black Market Premium	
				1970s	1980s
Latin America					
- Argentina	1991	0,294	0,055	0,38	0,34
- Bolivia	1985	0,129	0,042	0,23	1,19
- Brazil	1991	0,159	0,047	0,19	0,36
- Chile	1976	0,213	0,098	2,12	0,19
- Colombia	1991	0,310	0,520	0,09	0,05
- Costa Rica	1986	0,157	0,703	0,21	0,40
- Mexico	1986	0,082	0,064	0,02	0,21
- Paraguay	1989	0,463	0,370	0,45	0,04
- Peru	1991	0,409	0,370	0,45	0,04
- Uruguay	1990	0,207	0,030	0,27	0,02
- Venezuela		0,182	0,002	0,00	0,47
East Asia					
- Hong Kong	has always been open	0,0	0,001	0,00	0,00
-Indonesia	1970	0,137	0,101	0,03	0,04
- Korea	1968	0,137	0,100	0,09	0,09
- Malaysia	has always been open	0,087	0,045	0,00	0,00
- Philippines	1988	0,221	0,467	0,08	0,11
- Singapore	has always been open	0,016	0,005	0,00	0,00
- Taiwan	1963	0,073	0,375	0,05	0,06
- Thailand	has always been open	0,294	0,055	0,00	-0,01

Source: Sachs and Warner (1995), tables 2 and 6.

It is well known that East Asia accepted the discipline of international trade much earlier than Latin America. Table 2 shows the striking dissimilarity between the regions concerning trade liberalization and trade policies. Even relatively closed countries like Korea and Indonesia opened to trade long before the typical Latin

American country[6]. Out of the East Asian countries analyzed, four have always been open to trade and, even the relatively closed ones have low tariff rates compared to Latin America. Except for Taiwan, they present low levels of non-tariff barriers and no East Asian economy has significant black market premiums in the sample period.

Latin America's situation is radically different. As recently as the mid-1980s the protectionist view sponsored by ECLA - United Nations Economic Commission for Latin America - was still highly influential in many countries. Industrial policy was strongly based on import substitution policies which played down the role of prices on resource allocation. As a result, Latin America's external sector was probably the most distorted in the world. Import protection, both in terms of tariff and non-tariff barriers, was extremely high as shown in table 3. One major consequence of such policies was a strong bias against exports.

Again, as was the case of the VAT, during the pre-reform periods, tariff dispersion was much higher in Latin America than in East Asia. The development strategy based on import substitution created highly dispersive tariff structures (Table 3). As an example, during the 1960s, Brazil, Chile and Colombia had the highest rates of tariff dispersion in the world. These high dispersion levels did not follow from optimal theory recommendations. They were, according to Edwards (1994), "the result of decades of lobbying by different sectors to obtain preferential treatment" and therefore brought about serious distortions on resource allocation.

Table 3
Average Effective Rates of Protection in Manufacturing in Developing Countries, 1960s-1970s

Countries	1960s			1970s		
Latin America	Year	ERP[a]	STD[b]	Year	ERP[a]	STD[b]
- Argentina	1969	95	100	1977	46	46
- Brazil	1967	80	46	-	-	-
- Chile	1961	346	634	-	-	-
- Colombia	1969	88	166	1979	56	27
- Costa Rica	1968	23	15	-	-	-
- Mexico	1960	32	24	1970	39	34
- Uruguay	1968	411	304	-	-	-
East Asia						
- Korea	1968	14	44	-	-	-
- Malaysia	1963	32	58	1970	68	66
- Philippines	1965	42	130	1974	60	82
- Singapore	1967	6	10	-	-	-
- Taiwan	1966	84	62	-	-	-
- Thailand	1969	16	29	-	-	-

a: Unweighted average effective rate of protection; b: Standard deviation of ERP
Source: Heitger (1987), Table 3, p. 256

In such a context, it is clear that the answers to both questions are affirmative. Doubtlessly, the scope for reforming trade taxes was much broader in Latin America as tariffs were higher and much more dispersed. By the end of the 1980s, in line with the international tendency towards greater integration, Latin America began its process of trade liberalization. The pioneer country was Chile, which between 1975 and 1979 reduced substantially its degree of protection. This country adopted a uniform tariff rate between 10 percent and 15 percent. By now, most Latin American countries have reduced tariff rates and are moving towards more simplified tariff structures. Additionally, another important goal of Latin American trade reforms has been the reduction of the degree of dispersion as it can be seen from table

4. Indeed, not only the prohibitive maximum rates were reduced as minimum rates were, in some cases, increased.

Table 4
Range of Imports Tariffs in Selected Countries of Latin America
(In percentage)

Countries	1980s			Current		
	Year	Minimum	Maximum	Year	Minimum	Maximum
Early Reformers						
- Bolivia	1985	0,0	20,0	1991	5,0	10,0
- Chile	1987	0,0	20,0	1992	11,0	11,0
- Mexico	1965	0,0	100,0	1992	0,0	20,0
Recent Reformers						
- Argentina	1987	0,0	55,0	1991	0,0	22,0
- Brazil	1987	0,0	105,0	1992	0,0	65,0
- Colombia	1966	0,0	200,0	1991	0,0	15,0
- Costa Rica	1966	1,0	100,0	1992	5,0	20,0
- Paraguay	1984	0,0	44,0	1991	3,0	36,0
- Peru	1987	0,0	120,0	1992	5,0	20,0
- Uruguay	1966	10,0	46,0	1992	10,0	30,0
- Venezuela	1987	0,0	200,0	1991	2,0	40,0

Source: Edwards (1994), Table 2, p. 20.

As said earlier, the adjustments required in the East Asian countries, were much less compelling. Except for the Philippines, those countries were among the early reformers and thus their trade policies were less distorted. Compared to Latin America, trade barriers were lower and tariff rates less dispersed. To face the increasing pressures of a globalizing world, most of the East Asian countries had only to cope with fine-tuning adjustments. In a sharp contrast, Latin America, required fundamental trade tax reform in order to guarantee the feasibility of the opening process.

Regarding export taxes, both regions followed the international trend to reduce the importance of these taxes. Except for Costa Rica and Malaysia, in recent years no country derived more than one percent of GDP from export taxes. Costa Rica exports basically agricultural products and cannot rely on corporate income taxes to collect revenue. Thus, this country has no better alternative than to tax agricultural production through export taxes. Thus, for Costa Rica, export taxes function as a proxy for land taxation. Malaysia taxes both agricultural and oil exports.

2.2 Recent Trends in Income Taxation

Reform of income taxation has been an important part of tax reforms. Measures adopted by reformers generally aimed at encouraging the taxation of income on a less distortionary way. Such measures often include rate reductions and attempts to establish simple and well-defined bases. This section will briefly describe the main points of these reforms and compare the patterns adopted by each region.

Countries in both regions have followed the international tendency to reduce maximum personal income tax rates and simplify tax structures. Bolivia adopted a flat rate of 10 percent and Uruguay only recently reintroduced a tax on personal income. The notable exception to this tendency is Singapore, where the personal income tax system continues to have a large number of tax rates. Furthermore, in Latin America, there was no preoccupation with increasing minimum rates neither there was a concern for surtaxing the richer. Consequently, revenues from this source are dwindling in the region[7].

It is worth noticing that radical personal income tax reforms are likely to be found in Latin America. While East Asian countries follow a more predictable pattern, Latin American reforms incorporate rather audacious tax changes. For instance, Uruguay in 1974 and Bolivia in 1986 were apparently the only countries in the whole world to abolish personal income taxes[8]. However, such drastic simplifications are costly to implement - including in political terms - and, so they tend to be more difficult to sustain. Not infrequently, they are quickly dismantled. That was the case of Bolivia, where the elimination of personal income tax was reverted. Uruguay also reintroduced this tax recently. This unstable pattern hinders the credibility of reforms and undermines the confidence on the tax system.

Regarding corporate taxation, both Latin America and East Asia, following worldwide trends, reduced rates and tried to enlarge the tax base. Only Brazil, did not follow this trend for a certain time. The Brazilian corporate income tax rate increased between 1980 and the earlier 1990s[9] and this country has also maintained a myriad of tax incentives. Only recently, reforms are succeeding in putting the Brazilian rates in line with the worldly tendency. By now, we observe a convergence on tax rates across regions and countries. Most countries fixed their rates around 30 percent. Exceptions are Chile and Hong Kong where rates are much lower: respectively 15 percent and 17,5 percent. Oil is heavily taxed in both regions.

Concerning withholding taxes, considered an important element of reforms, there are significant differences across and within regions. In Latin America rates vary greatly, ranging from

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[7] See Receita Federal 1994) and Sampaio de Sousa (1996).

[8] It should be noticed that in Uruguay introduced personal income taxes for the first time in the early 1960s, but that tax never raised significant revenue.

[9] The corporate tax rate in Brazil includes a general rate of tax, a surcharge, a state capital income tax surcharge and a contribution to the social security system. The total corporate tax rate in 1992 was over 50 percent (including the withholding tax). The state surcharge has been eliminated , and in 1996 corporations pay a 15 percent basic rate, a 10 percent surcharge on net profits over R$ 240.000,00 and asocial contribution of 8 percent on net profits.

zero to 35 percent. Chile applies a high and uniform rate on dividends, interests and royalties. Moreover, this country does not have preferential rates for particular--treaty-- countries. Argentina, Brazil and Venezuela exempt dividends and apply relatively low rates for interests. In East Asia, Hong Kong, following its tradition as a successful financial center, does not have withholding taxes. Notice that rates are more differentiated in Latin America. Only Chile and Bolivia use uniform rates whereas in East Asia the variability of tax rates is much lower than in Latin America. As was the case with the corporate income tax, partial recent reforms show a tendency to rate reductions in most countries of both regions.

Up to now the discussion was centered around changes in nominal rates. However, experiences with tax reform call attention to the gap between nominal and effective tax rates. Such discrepancies are brought about by distortions present in the economy as well as tax exemptions and privileges that drive a wedge between nominal rates and the ones effectively applied. Consequently, the relevant information on the magnitude of the tax burden may not be adequately reflected by nominal rates but by the evolution of effective rates. These rates indicate to what extent the after-tax rate of return on capital differs from a given before-tax rate of return and, therefore, constitutes a better basis to evaluate the effect of tax reforms.

Effective rates depend on several factors. Depreciation allowances, inventory cost deductions and tax incentives may strongly affect the company's tax liabilities and thus should be taken into account for a more accurate assessment of effective taxation on capital. A relevant question is to assess how the countries examined had to reform taxes in order to maintain their tax systems environment attractive for foreign direct investment. Two further points are: How effective tax rates evolved in Latin America and East Asia? Did they have follow the same trends of nominal rates?

Recent studies have shown that effective rates tend to be much higher in Latin America than in East Asia[10]. Such a result is basically explained by the existence, in Latin America, of a more

[10] See Boadway and Shah (1995), Mintz and Tsiopoulos (1996), Sampaio de Sousa (1996) among others.

distortionary indirect taxation. In particular, higher trade taxes on capital goods in the former region are responsible for the high effective rates observed. Mintz and Tsiopoulos (1996) have found that the removal of capital tariffs may greatly reduce effective capital taxation. They also found that sales and excise taxes impose a significant burden on the purchase of capital goods. Hence, the higher tariffs prevalent in Latin America not only prevented the region from benefiting of international competition. They also had additional costs in terms of investment thus restraining the long-run economic growth of the Latin American economies.

Therefore, in spite of the fact that in recent reforms, tax changes in Latin America followed the international trend and were designed to reduce tax distortions, such a movement was not replicated by effective rates. In the region a considerable effort is still required to make capital taxation more neutral and efficient. The analysis of Mintz and Tsiopoulos clearly indicates a direction to reform: if Latin America is to attract foreign capital it has to reduce domestic taxation so that effective rates could be lowered.[11]

Finally, another crucial element of direct-tax reform has been the integration of the systems of personal and corporate income taxes. Although no full integration scheme is applied in any part of Latin America and East Asia, there is a movement toward such integration in both regions. In East Asia, partial integration of personal and corporate income taxes is adopted by Malaysia and Singapore. Profits are taxed at the corporate level, but credit is provided for the corporate tax paid if profits are distributed to shareholders. Indonesia, The Philippines and Thailand use the principle of separate taxation thus incurring in double taxation. In Latin America, only Chile and Mexico integrate the withholding tax on dividends with the corporate income tax. In January 1996, Brazil introduced a form of integration where corporate profits become free of withholdings or personal income taxes when redistributed.

[11] Sampaio de Sousa (1996) shows that indirect taxes play a central role in government finances in Latin America. The skewed income distribution together with the political instability in the region represent a serious limitation for significant increases in the role of direct taxes --specially personal and property related taxes. In addition, the high reliance on indirect taxation is explained by the difficulties of taxing the relatively large agricultural sector.

Mexico e Colombia reduced corporate tax rates in order to make them compatible with personal rates. Finally, it should be stressed that integration has been carried out also to prevent tax arbitrage and remove distortions as a highly distortionary direct tax system reduces potential profits, increases the corporate tax burden and thus hinders investment.

3. Tax Administration

Weak tax administration is a widespread characteristic of most of the tax systems analyzed. Yet, administrative effectiveness is crucial to the success of reforms. There is now an ample consensus on how to achieve such administrative efficiency. In particular, reforms should envisage the simplification of the tax system. Complex tax rules are thought to provide strong incentives to avoid and evade taxes thus undermining the ability of the tax system to collect revenues and achieve horizontal equity. The removal of exemptions, loopholes and concessions, the use of presumptive taxation, and withholding tax, among other measures, are endorsed by fiscal specialists as actions to simplify tax administration and curtail evasion. By making tax laws simpler, it is possible to concentrate administrative resources to audit and collection activities[12]. Finally, tax enforcement is also essential for the success of tax reforms; it can be achieved through the effective use of sanctions and penalties. In such a context, the relevant question is to What extent Latin America and East Asia, when adjusting their tax systems, have followed those well-accepted recommendations?

First, it should be noted that the scope for tax evasion seems to be more important in Latin America than in East Asia. The likely causes are related to the complexity of tax structures in the former region which is partly explained by the fact that multiple and, sometimes, inconsistent roles are attributed to the tax system. In Latin America, until recently, the tax system was used not only to

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[12] Frequent tax audits, to force compliance and guarantee revenues, are very important, specially random audits, as opposed to targeting only the large taxpayers. Enforcing taxes mainly on the largest companies may maximize revenue but also tend to encourage the expansion of the inefficient, less taxed, sectors of the economy.

collect revenues; it was supposed also to correct income disparities and protect the economy. Such multiple objectives increase administrative costs and create incentives to tax avoidance and evasion thus resulting in significant wedges between statutory and effective rates. In East Asia, it appears that a more restricted vision about the role of taxation has led governments to adapt their tax system on a more consistent and simple manner.

Regarding tax enforcement, we find a distinctive characteristic between Latin America and East Asia. It is well known that it is difficult for any government to enforce tax too harshly on politically influential groups. Yet, in the latter region, except for Philippines, the absence of large inequities meant that the government had no need to struggle against powerful industrial or landed groups[13]. Consequently, it was much easier to implement and enforce the required tax changes. In Latin America the situation was different. Not infrequently, strong political pressures prevented the enforcement of property and wealthy taxes and, repeatedly, threatened the continuity of reforms.[14] Here it is worthy to restate that the Philippines' pattern is more in line with the Latin American typical experience. Powerful landlords together with a highly protectionist business class effectively prevented the Philippine state to collect taxes from real property and reform a highly distortionary trade taxation[15].

Stability, transparency and honesty are also crucial to achieve and maintain the indispensable popular support required by successfully implemented reforms. The misuse of public power and public funds, the concessions of advantages based on illegal practices like bribery may seriously hinder the credibility of tax reforms and undermine the incentives for voluntary compliance. Hence, the probity of public officials and politicians is a fundamental element to guarantee the society's indispensable endorsement of the required tax changes. Concerning this question, do Latin America and East Asia face the same constraints and behave in a similar way, or do they follow a different pattern? What

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[13] In Taiwan and Korea, land reform and foreign occupation contributed to weaken such groups (see Rodrik (1994)).
[14] See Arellano and Marfán (1989), Urrutia (1989), Bird (1989, 1992).
[15] For a good discussion about the Philippines' case, see Fontes (1989).

can be said about the differences between Latin America and East Asia on such matters?

Unfortunately, those are not easy questions to answer. Indeed, it is very difficult to have objective measures of government honesty and transparency as they involve concealed actions and, not infrequently, illicit transactions. Yet, a roughly indicator exists: the International Corruption Ranking (ICR) published annually by the Gottingen University. The ICR tries to assess the degree to which public officials and politicians in particular countries are thought to be implicated in corrupt practices. It is based on the perceived level of corruption and do not necessarily reflect the real level of corruption.[16] A score of 0 means that a country is perceived as totally corrupt; 10 that it is perceived as totally clean. No country scores 10 or 0. The variance indicates the degree of deviation among the assessments made by different sources.

The ICR indicator and its variance for Latin American and East Asian countries are shown in Table 5. In the Latin America, except for Chile, countries rank very low indicating that individuals and firms do not think very high of public officials and politicians. The Chilean result confirms the findings of Haberger (1989), who attributes most of the success of reforms in Chile to "the cultivation of a clear sense that the law was being enforced evenhandedly" and that "the VIPs were not able to escape the tax net." East Asia clearly presents a higher average. Singapore has the highest ICR of the sample, comparable only to best marks of the developed countries, showing the people's confidence on the bureaucracy and rulers. Hong Kong, Malaysia, and Taiwan also perform very well while the Philippines and Indonesia present scores comparable to lowest Latin American scores. These results indicate that the conditions for obtaining popular support for the introduction and maintenance of reforms are, very probably, more propitious in East Asia than in Latin America.

Nevertheless, honesty and transparency do not suffice to guarantee the success of reforms. Their implementation is greatly helped by the existence of a competent, honest and efficient

[16] More details about this index can be found in the Internet (http://www.uni-gottingen.de/~uwww/icr.htm).

bureaucracy capable to administer the multiples tasks inherent to reforms. This is not an easy requirement. In many countries of both regions such a bureaucracy is not available. Yet, in East Asia, particularly in Singapore, Taiwan, and Korea, the higher concern for education contributed to create a relatively skilled labor force that permitted the formation of a competent bureaucracy, well-paid and socially respected. This bureaucracy together with a clear-sighted political leadership that consistently emphasized economic priorities certainly played a crucial role on the region's remarkable performance and has surely contributed to the success of tax reforms.

Table 6
Corruption Rankings in Selected Countries of Latin America and East Asia - 1996

Countries	Ranking	Score	Variance
Latin America			
- Argentina	7	3,41	0,54
- Bolivia	8	3,40	0,64
- Brazil	12	2,96	1,07
- Chile	3	6,80	2,53
- Colombia	13	2,73	2,41
- Ecuador	11	3,19	0,42
- Mexico	10	3,30	0,22
- Venezuela	16	2,50	0,40
- Unweighted Average		3,53	
East Asia			
- Hong Kong	2	7,01	1,79
- Indonesia	15	2,65	0,95
- Korea	5	5,02	2,30
- Malaysia	4	5,32	0,13
- Philippines	14	2,69	0,49
- Singapore	1	8,80	2,36
- Taiwan	6	4,98	0,87
- Thailand	9	3,33	1,24
-Unweighted Average		5,00	

Source: Transition: The News Letter About Reforming Economies , Vol. 7, Nº 7-8, July-August 1996, p. 16-17.

Latin America faces a different situation. Urrutia (1989), referring to the Colombian case, noted that "a poorly paid bureaucracy, with little social prestige is particularly prone to leave powerful taxpayers alone and to investigate them not to increase taxes but to obtain bribes." Of course there may be exceptions across countries, but Urrutia's vision certainly does not represent a particular case in the continent[17]. According to Ascher's words, in Latin America "the very initiative of tax reform typically puts the tax administrator on the defensive[18]." Administrative reform is often considered an implicit disapproval of the current methods of tax management and perceived as a threat to the position and prestige of tax bureaucrats[19]. This perception certainly hinders the implementation and enforcement of reforms.

Finally, reforms in both regions have made efforts to create a unique taxpayer identification number and fostered the computerized processing of tax returns thus facilitating the cross checking of information. Tax collection was channeled through commercial banks. This minimized the connections between tax officials and taxpayers thus reducing the risk of corruption.

4. Tax Reforms and Income Inequalities

Whereas considerations of income distribution and vertical equity were prominent during the 1960s in discussions about tax reforms, emphasis was shifted afterwards to economic neutrality, administrative considerations, and horizontal equity. Little concern with income distribution in recent years reflects a general reduction of interest among specialists regarding distributional issues due to a disenchantment with the results of government-directed tax policies. The available empirical evidence seriously questioned the

[17] Of course, the clear exception is Chile as we previously noticed. Colombia is also considered to have the best tax system in Latin America and recently made serious effort to improve tax administration (see McLure and Zodrow (1991)).
[18] Archer (1990).
[19] On the issues of administrative reforms see Bird (1989), McLure and Zodrow (1991), McLure and Pardo(1991).

potential redistributive impact of reforms even if tax policy, mainly in Latin America, continues to claim the goal of attenuating social inequalities. As a result, recent reforms are increasingly oriented towards tax neutrality and efficiency issues.

This section inquires into what extent such tendencies were followed in each region and how tax policies were employed to influence the region's profile of income distribution. Has East Asia as well as Latin America extensively made use of tax policies to correct income disparities? When adopted, did reforms pursuing vertical equity achieve the goals intended or were they income-ineffective, that is, did they increase or decrease inequalities in Latin America and East Asia? Were the modifications on the tax systems progressive or regressive? Answers to these questions are not simple as they involve multiple elements. In particular, they depend on controversial tax incidence assumptions as well as they involve the relationship between the nominal and effective progressivity of taxes.

To tackle these issues, it should be noted that there is a marked difference between Latin America and East Asia regarding the role played by taxation on income distribution. In Latin America, attempts to redistribute income tended to rely heavily on tax policy while in East Asia, it seems that efficiency rather than equity considerations predominated on the determination of the system of taxation.

- In Latin America, the results of such attempts are extremely disappointing. This confirms the findings of several studies showing that taxation is a very poor device to correct income disparities generated by market imperfections and successive interventionist policies.[20] In this region, the adoption of complex tax systems that aimed at reducing social disparities did not significantly change income distribution. The difficulties in administering these nominally progressive tax systems produced perverse effects. Very often, this form of taxation turned out to be highly regressive because its complexity encouraged tax evasion.

[20] See the excellent survey by Bird and De Wulff (1973) on the Latin American case as well as Andic (1977) and Snodgrass (1977).

Governments reacted to the shrinking of its revenue by imposing higher tax rates and thus created an additional incentive for tax evasion[21].

- In East Asia, the better income distribution lessened the need to use taxation as an income redistributor. The tax system was directed instead to generate the revenues required by the expansion of public expenditure policies. Such policies have been quite efficient and played an important role in creating and preserving a more equitable form of economic growth. In particular, public spending with basic education --an important determinant of income distribution-- were above the average of developing countries, contributing to increase the supply of skilled labor[22]. Consequently, productivity gains associated to a very efficient absorption of modern technology increased wages and employment thus reducing poverty and attenuating income disparities.

In the light of the new evidence, East Asia seems to have made a better choice. Indeed, policies of public spending appear to be more efficient than tax policy in attenuating income disparities and reducing poverty levels. Promoting equality by increasing the availability of public goods is a very promising route as recent studies have shown that the potential of public spending to reduce economic inequalities have been underes-timated.[23]

What are the reasons behind such divergent pattern? Why did Latin America and East Asia choose opposite ways to tackle the distributive issues? Although we can not summarize the complex and numerous forces at play, the influence of three important factors, namely, income distribution, intellectual beliefs and inflation should be emphasized.

First, the extremely high levels of income disparity that characterizes Latin America is a natural justification for the adoption of more equity-oriented reforms. Increasing social pressures led successive governments to try to minimize the long-term trends of inequality through tax policy. In East Asia, an initially

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[21] See Bird and de Wulff (1973), Altimir (1994), Shah and Whalley (1991).
[22] See Barro and Lee (1993)
[23] Haberger (1977), Goode (1984), Sen (1981), Cornes (1982) among others.

better income distribution coupled with a labor-intensive development strategy reduced poverty and lessened the distributive pressures. This region was, thus, able to escape the pitfalls of complex distributive-oriented tax systems[24].

Furthermore, the role played by intellectual beliefs should not be understated. As previously said, ECLA's economic doctrine which downplayed the market element and pointed to a higher degree of state intervention certainly contributed to the development of distributive-oriented tax incentive programs adopted by many Latin American countries. Pressed by a skewed income distribution and motivated by a strong populist tradition, Latin American governments tended to adopt tax policies that emphasized redistribution and minimized the risks of inflationary pressures inherent to fiscal imbalances.[25] In East Asia, in spite of the existence of a marked state intervention, such interference was clearly distinct. As Tanzi and Shome (1992), pointed out, in this region "the government's role was limited to its traditional functions, namely, the provision of social and economic infrastructure, the maintenance of a stable macroeconomic framework and the promotion of growth." Government actions were not conflicting with market forces but aimed at reinforcing those forces.

Finally, the regressive nature of the inflation tax and its negative impact on poverty and income distribution should not be overlooked. In Latin America, the tradition of government financing through inflation surely represents an additional burden on the poor. Even in highly indexed country like was Brazil until recently, the inflation tax paid by the lowest quintile as a share of their income reached 1.6% in 1990 (Cardoso(1992)). For countries lacking a sophisticated indexation system this tax could be much higher. Tanzi (1996) calculated that tax revenues from *seigneuriage* were much higher in Latin America than in East Asia (Table 6).

[24] For data on income distribution see Table A-1 in the appendix.

[25] Various studies have shown that populist policies have been extremely inefficient to reduce the social inequalities that characterize Latin America. An excellent analysis of economic populism in Latin America could be find in Dornbusch and Edwards (1990).

On that account, most Latin American countries reformed their tax systems to include inflation adjustment. Yet, as tax indexation is not complete it creates a bias against wage earners and may distort the income distribution. As an example, in a partly indexed tax system, inflation often raises effective tax rates on labor income while reducing them on capital income. This occurs because workers' wages move into higher tax brackets ("bracket creeping") whereas nominal interest deductibility reduces the corporate income tax base. So, in the presence of inflation, full indexation, more than extremely differentiated tax structures, may contribute to neutralize the distortive effects of taxation.

Table 7
Tax Revenue From Seigneuriage in Selected Countries of Latin America and East Asia - 1984

Countries	Tax Revenue From Seigneuriage - 1984	
	Percent of GDP	Percent of Current Revenue
Latin America		
- Argentina	7,4	46,5
- Brazil[1]	2,5	9,1
- Chile	0,9	2,7
- Mexico	7,2	41,9
- Peru[1]	8,7	58,0
- Venezuela	1,5	5,7
East Asia		
- Indonesia	0,7	6,2
- Korea	0,1	1,4
- Malaysia[2]	0,1	0,5
- Philippines	2,4	22,1
- Thailand	0,2	1,3

Source: Tanzi (1996)

5. Selected Eexperiences of Tax Reforms in Latin America and East Asia

More recently, major tax reforms took place in many countries in both regions. In this section they are compared to detect differences and similarities on patterns of reform. Below, the main features of the most important experiences with recent tax reforms in selected countries will be briefly discussed.

5.1 Latin America

Latin America has by now a considerable experience with reforming its tax system. In 1967 Brazil made a significant reform that introduced the VAT. During the seventies, Chile, Mexico and Uruguay also made deep reforms. Argentina, Bolivia, Colombia and Mexico too have undertaken important changes on their tax systems during the 1980s.By now, rounds of tax reform are on the policy agenda in Brazil and other Latin American countries. Here, the main points of the Bolivian, Argentinean, Mexican and Colombian reforms will be briefly stated.

Bolivia: Before the 1980s Bolivia, as a small open country, relied heavily on trade taxes which accounted for a significant share of tax revenue. Personal income taxes were comprehensive and progressive, with a top rate near 50 percent. In practice, this progressivity was sharply reduced by evasion and a myriad of exemptions. A uniform 30 percent was levied on net business income and special rules applied for small business and natural resources companies. In 1973, a value-added tax was introduced on a broad basis at a rate of 5 percent. Later, the number of rates and exemptions was greatly increased. The tax was poorly enforced resulting in widespread evasion and low revenues. The bulk of public revenue continued to be derived from the traditional excise taxes.

The Musgrave report reviewed the Bolivian tax system and pointed out to the need to strengthen the domestic tax base to reduce the vulnerability of the tax system to external shocks due to its extreme dependence on trade taxes. The recommendations of the

Musgrave report were ignored until Bolivia was caught, early in the 1980s, by an extremely serious fiscal crisis. When the world recession hit the country, domestic pressures increased inflation and tax revenue fell dramatically. It went down from an average of 11 percent of GDP in the seventies to 3 percent in 1984. Such circumstances led to a complete reform of the tax system in May, 1986. This reform replaced a highly differentiated tariff system (with rates as high as 150 percent) by a uniform tariff of 20 percent, later reduced to 10 percent. A 10 percent VAT on imposed on a broad base. This tax was supplemented by excises on luxury goods, tobacco and alcoholic beverages and by a 1 percent transactions tax – a cumulative turnover tax.

Concerning direct taxes, the Bolivian tax reform of 1986 was quite radical. Personal and corporate income taxes were eliminated and replaced by three new taxes: a) a progressive tax was imposed on all owners of real state property and vehicles[26]; b) the enterprise tax was replaced by a 2 percent tax on the net worth of public and private enterprises. Consequently, most investment incentives that proliferated in Bolivia disappeared; c) finally, a simplified tax consisting of a fixed amount determined on the basis of self-declared gross sales was imposed on very small enterprises.

Another important characteristic of the Bolivian tax reform was the administrative element. Tax collections were removed from the Ministerio de la Hacienda to a newly created Ministerio de las Recaudaciones, restructured with a new, skilled and motivated staff.[27] For the first time in Bolivia, a successful campaign to enlist new tax payers was launched. Substantial efforts were made to strengthen tax enforcement. Additionally, tax collection was channeled through commercial banks. This reform was quite successful. It has increased tax revenues from 3 percent of GDP in 1983 and 1984 to 13 percent in 1986 and 17 percent in 1987 and reduced the vulnerability of the tax system to external fluctuations and inflation.

[26] The rates varied from 1.5 to 5 percent for vehicles and 1.5 to 3 percent for real states holdings.

[27] This ministry was later reincorporated into the Ministry of Finance.

Argentina: Chronic inflation coupled with poor economic growth eroded the base of the Argentinean tax system. Tax revenues fell from 22 percent of GDP in 1986 to only 16% of GDP in 1988. Such a situation called for the tax reforms of December 1988. The key point was to reform the value-added tax by broadening its base and improving its administration; Yet, administrative inefficiencies together with the concessions of exemptions and the creation of a new rate of 7 percent for some goods, reduced revenues thus eliminating the effectiveness of the VAT reform. Concerning direct taxes, the main point of reform was the reduction of the income tax rates. They were reduced, from a range of 10-45 percent to 6-35 percent. The net wealth tax rate was also reduced. As a result, revenue increases by this reform came, uniquely, from increases in the traditional excises rates.

When Menem came to power the tax system was close to a collapse. The need for a drastic tax change was clearly signaled by the failure of the 1988 reform. In late 1989, a set of proposals was presented by the government. Those proposals were clearly inspired by the tax changes implemented in Bolivia in 1986 (and earlier, in Chile and Uruguay). The 1989 reforms greatly simplified the tax system by eliminating a number of taxes that yielded little revenue or provoked strong inefficiencies in the economy.[28] Different payroll taxes were consolidated into one simpler levy. A broad-based VAT was introduced at a uniform rate of while a 20 percent flat-rate income tax was imposed. The corporate income tax rate was cut from 33 to 20 percent and dividends were exempted from personal income taxes[29] The net worth tax was replaced by a 1 percent tax on gross corporate assets. Finally, there was also a significant simplification of the trade taxes, even if they were still quite differentiated. This tax reform has been moderately successful.

Mexico: In 1980, a broad-based VAT was introduced at a uniforr rate of 10 percent. The tax system was also considerably simplifie by eliminating a large number of unproductive consumption taxe: In 1983, a fiscal crisis reduced the simplicity of the 1980s reforn and the basic VAT rate was raised by to 15 percent while severa additional rates were introduced. Excise taxes were also increase as well as income tax which was supplemented by a 10 percen surtax. Furthermore, to reduce distortions provoked by inflationar changes in tax bases and protect revenues, inflation adjustment were introduced in corporate and personal income taxes Collections lags were also significantly reduced. In 1990, a percent tax on the inflation-adjusted assets of firms along the line: of the Bolivian and Argentine taxes was introduced.[30] Finally, a fla 10 percent tax was levied on dividends paid to individuals.

The most remarkable characteristic of tax reform in Mexicc is the fact that every reform was presented as an improvement over previous experiences. There was no place to radical reforms as was the case in Argentina and Bolivia. The Mexican case is much close to a fine-tuning policy than to drastic changes in the tax system as responses to fiscal crisis.

Colombia: The most significant feature of the Colombian tax reforms is the frequency with which they were undertaken. Indeed, they represent a continuous process of adjustment to economic changes. The first major tax reform in 1974 concentrated on the income tax and increased the progressivity of the tax system. However, administrative inefficiencies together with inflation and political pressure contributed to erode this reform. Afterwards, many reforms were undertaken, of which the most important one, in 1975, introduced a VAT at a uniform rate of 10 percent. By 1986, another major tax reform was implemented. Unusually for Latin America, this reform was neither a response to a revenue crisis nor based on equity considerations. In fact, it was a neutral tax reform intended to reduce the economic distortions provoked by inflation. Attempts to simplify the tax system were undertaken by

[30] As in Argentine, this tax functioned as a minimum corporate tax. The enterprise pays either, the assets tax or the corporate tax, whichever is larger.

abolishing personal exemptions, income splitting, and most deductions. There was a clear intention of increasing efficiency by lowering tax rates and broadening the base. In that sense, this reform realized better the limits to achieve equity through tax policy and recognized the constraint imposed by administrative feasibility.

Summarizing, in spite of successful experiences with tax reform, Colombia is still too concentrated on redesigning the tax system around its imperfections and has not paid enough attention to the essential task of improving tax administration. Even, if some steps have been taken in that direction, Colombia has not yet overcome the crucial problem common to many Latin American countries, namely, the political difficulties of enforcing taxes on rich and influential tax payers.

5.2 East Asia

In this section the main tax reforms adopted by selected East Asian countries will be briefly reviewed. The experiences of Indonesia, Korea and the Philippines will be analyzed. The first two countries had successful reforms while the last one failed in its intention to reform its tax system.

Indonesia: In spite of the existence of many problems in the tax structures and tax administrations, in Indonesia, there was no significant tax reform initiative until the 1980s. This was due to the massive government revenues from oil and natural gas collected in the period 1973-1981. Dependency upon oil revenues became even more important after the second oil boom in late 1978.[31] Eventually, as a result of the fall in oil prices in early 1980s, the government decided to implement a fundamental tax reform in order to reduce the extreme dependence on the oil sector. The reform was comprehensive and well designed. The key feature was the replacement, in 1985, of an outdated sales taxes by a VAT at a flat rate of 10 percent on all taxable transactions. A luxury tax was also applied on a very limited number of income elastic products at

[31] By 1981, the ratio of non-tax oil to GDP was as low as 6.1 percent, possibly the lowest in the world (Gillis (1989)).

rates of 10 percent and 20 percent , those items being also subject to ordinary VAT. Concerning direct taxes, neutrality objectives clearly dominated. A unified personal and corporate income tax at rates of 15, 25 and 35 percent replaced the old, multiple rate tax. A new property tax on urban real state was introduced in 1986. Income tax incentives were eliminated.

Indonesia tax reform reduced distortions associated to the previous tax system. In revenue terms, this reform has been successful beyond expectation. Dependence on oil receipts was sharply reduced. Receipts coming from the VAT were as high as 3.3 percent of GDP for the period 1986-1992, compared to only 1.3 percent yielded by the previous turnover tax. The overall revenue effect has been broadly neutral. However, revenue is now collected in a more coherent and efficient basis and is less dependent on the instabilities of the world oil markets.

Korea: One of the most distinguished characteristics of Korea's tax reform is the fact that tax policy changes have been made almost continuously since 1953.[32] From 1961 on, five major tax reform were undertaken, the last one in 1986. Afterwards, small adjustments of the tax system are being regularly undertaken.

Two crucial reforms were carried out in the mid-1970s. Firstly, the 1975 reform accomplished an important simplification of the income tax system. The 1977 reform introduced important changes in the indirect tax system: a value-added tax at a rate of 10 percent was created. The business tax was replaced by a set of special excises levied on certain commodities, namely, textile products, petroleum products, electricity and gas, transportation and entertainment. These reforms shaped the basic structure of the current tax system.

During the eighties, the most significant tax reform took place in 1982. The key point of this reform was the review of the tax incentive system. It also lowered personal and corporate income tax rates. The more recent tax reforms emphasize equity considerations and question the system of tax incentives. For the

[32] For a more detailed description of tax reforms in Korea see Kwack and Lee (1992).

near future, the most challenging issue will be the management and enforcement of the property-related tax system.

Finally, it is worth mentioning that, in Korea, there was an early recognition of the importance of tax administration. The office of National Tax Administration (ONTA), created in 1966, was quite successful in raising substantially the tax/GDP ratio[55]. The Korean government early realized that the problem was less with the taxation system as conceived and made into law than with its implementation and enforcement. As a result, the emphasis given on tax administration was very likely responsible for Korea's success in its numerous tax reforms.

Philippines: The Philippines' tax reform of 1986, implemented in 1988, like other reforms in developing countries aimed to simplify the tax structure making it more neutral, broadening its base and raising additional revenue. The reform included: a) a movement from schedular to global income taxation; b) the unification of corporate income tax at a 35 percent rate; c) the replacement of the sales-turnover tax by a uniform 10 percent VAT; and d) the elimination of export taxes except those on logs and lumbers.

The results of this tax reform were modest. In particular, the performance of the Vat was rather disappointing; its receipts in relation to GDP were little increased over the pre-VAT period. Lack of appropriated administrative mechanisms and poor implementation seen to be responsible for such a result. Consequently, the bulk of revenue from indirect taxes continues to come from the traditional, excise taxes. Moreover, the elimination of all export taxes led to a loss of a steady source of revenue that the country has not yet replaced. Clearly, the Philippines are an example as simply changing the legal tax system does not guarantee a better performance of the fiscal indicators.

6. Concluding Remarks

Apparently, the main ingredients of tax reform were not very different between Latin America and East Asia. This is hardly surprising as the reforms undertaken in both regions followed the general world tendency. Their intellectual inspiration, very frequently, came from the same selected group of international fiscal specialists which are in agreement on the essential points of tax reforms. The reforms proposed envisaged to simplify tax structures, reduce trade taxes, replace the cumulative sales tax by a value-added tax, reduce the economic distortions associated to taxation, improve administration and increase revenue collection. The only clear difference is the emphasis put on equity goals in Latin America whereas in East Asia, such a preoccupation played a secondary role.

Nevertheless, results are different according to the region. In East Asia, except for the Philippines, the tax reforms adopted seem to have been much more successful. Of course, more stable macro-economic context contributed for the successful implementation of the required fiscal adjustments in this region. In contrast, the highly unstable economic context in Latin America reduced the effectiveness of fiscal policies. Also, one should not forget the fact that some East Asian countries, like Korea, early diagnosed correctly that the success of these reforms required an efficient administration. Thereby, steps were taken to improve that aspect of reforms.

The political element in determining the success of tax reforms should not be understated. It is well known that tax reform needs political support. The more political unstable Latin America had much difficulty in reaching the necessary political consensus required for successful implementation of tax reforms. Such a consensus was so much difficult to reach as, in general, the changes required by reforms in Latin America tended to be more significant than the ones demanded in East Asia[34].

[34] An example of the importance of political stability for achieving success in tax reform is the Indonesian case. As Gillis (1989) pointed out, the continuity of the government and technical elite in this country was a crucial factor explaining the success of the 1983-1986 reforms.

The political instability that characterizes Latin America is reflected in the frequency stability and quality of its tax reform. East Asia, having a more stable political system, was able to implement and assure the continuity of the modifications in the tax system whereas in Latin America, too often, the effects of reforms were partly canceled by strong political pressures. Not surprisingly, Colombia, where the political situation has been more stable, presented the best results in adjusting its tax system. In East Asia, the political instability of the Philippines strongly restricted the ability of the government to raise taxes. Because of the feudal basis of political power, in this country, the operation of a democratic decision-making system led to fiscal paralysis; the subsequent authoritarian government did not succeed in implementing the necessary reforms.

Another important aspect of tax reform concerns the stability and persistence of tax reforms. Here, we can identify distinct patterns across regions. While in East Asia, results of tax reforms tend to be more permanent, in Latin America the situation is diverse. In this region, even when reforms are successful in simplifying the tax system, there are strong pressures to come back to the old complexity. According to Bird (1992), the typical Latin American pattern includes a drastic simplification of the tax system followed by a gradually increasing complexity motivated by political and economic necessities. This process continues up to the point where the complexities become uncontrollable and require another drastic reform. Such a seesaw pattern undermines the confidence of investors and hinders economic growth.

Finally, as Gillis (1989) pointed out, tax reforms tend to be more successful when they are not a response to severe short-term fiscal crisis. Without the pressures of acute crisis, policy makers and fiscal specialists have time to assess the consequences of major changes in the tax structure, to consider improvements in tax administration and solve the numerous problems associated with implementing tax reforms. In this respect, Latin America is also lagging behind East Asia. Indeed, in the former region fiscal adjustments are too often a response to punctual desequilibria and therefore have a lesser chance of contributing to a durable improvement of the tax system[35].

[35] Of course, there are exceptions to this general tendency. Bolivia and Argentina undertook long-ranging tax reforms in order to cope with a highly deteriorated economic situation and both reforms were quite successful.

The greater exposure to world markets may also have compelled East Asia to design a more efficient tax system in order to maintain international competitivity. As for Latin America, its relative economic isolation until the end of the 1980s, precluded the existence of significant pressures to adopt less distortionary tax systems. Therefore, the process of opening to trade and investment put a renewed urgency to reform the tax systems of Latin America in line with a more competitive world.

Last, but not least, notwithstanding what has been said above it should be kept on mind that Latin America has moved--and is still moving--towards a much more market-oriented development strategy. As part of those policies the continent is reforming its tax systems in a consistent direction with an open economy to trade and capital movements. Therefore, one should expect, in a near future, a convergence between the two regions analyzed regarding taxation.

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APPENDIX

Table A-1

Income Inequality in Selected Countries of Latin America and East Asia

Countries	Gini's Coeeficient			Ratio of top quintile's share of income to bottom's quintile
	Average	Minimum	Maximum	
Latin America				
-Bolivia (1990)	42,04	42,04	42,0	8,58
-Brazil (1960-89)	57,32	53,00	61,76	23,07
-Chile (1968-94)	51,84	45,64	57,88	14,48
-Colombia (1970-91)	51,51	46,00	54,50	13,94
-Costa Rica (1961-89)	46,00	42,00	50,00	13,13
-Ecuador (1992)	43,00	43,00	43,00	9,82
-Mexico (1950-92)	53,85	50,00	57,90	17,12
- Peru (1971-94)	47,99	42,76	55,00	9,21
-Venezuela (1971-1990)	44,42	39,42	53,84	10,93
East Asia				
-Hong Kong (1971-91)	41,58	37,30	45,18	9,46
-Indonesia (1964-93)	33,49	30,70	38,59	5,22
-Korea (1953-88)	34,19	29,82	39,10	6,29
-Malaysia (1970-89)	50,36	48,00	53,00	14,18
-Philippines (1957-91)	47,62	45,00	51,32	12,00
-Singapore (1973-89)	40,12	37,00	42,00	6,71
-Taiwan (1964-93)	29,62	27,70	33,60	4,67
-Thailand (1962-92)	45,48	41,28	51,50	11,65

Source: Deininger and Squire (1996), Table 1, p. 574-577.