COMMENTS ON SESSION IV: TAX REFORMS

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In these comments I focus on the last three papers of the session. The Barbone and Sanchez paper tells a compelling story of the political economy of reforms in the CIS. Its framework of analysis centres on (1) the stakeholders, (2) the process of interest aggregation through the political system, and (3) institutions. In Ukraine the main stakeholders were metallurgical and coal sectors, regional clans and the energy sector. The political system consisted of unstable factions in a mixed presidential and parliamentary system. The President's main support came from conservative industrial and financial groups. Significant institutional features included large tax arrears, particularly in the energy sector, and chaotic tax exemptions. The tax code was not approved and enforcement was weak. Weak enforcement meant low quality enforcement characterised by taxpayer harassment and politicisation of collection.

In Russia stakeholders are similar to in Ukraine, but other aspects of the environment are quite different. The main stakeholders in Russia are the larger privatised industrial companies, regional leaders and the energy sector. Prominent institutions include lobbying of the government and duma and the technical disadvantage of the tax authority compared to private companies. Transfer pricing is used aggressively to avoid taxation along with other methods of avoidance and evasion. Even local governments collude with companies to reduce the national government's tax share.

The Russian political system underwent something of a shock after 2000. The Russian president has greater power than his Ukrainian opposite number. Putin managed to reach a broad consensus of support in the 2002 election and this eliminated the need for dependence on oligarchs. Hence the oligarchs control of government broke down. Oligarchs themselves had anyway realised the need for reform after the 1998 financial crisis. Duma elections in 1999 had increased the power of reformist forces, reducing the number of seats held by the Communist Party.

The Matalík and Slavík paper describes the major reforms in the Czech taxation system. The main thrust of those reforms consisted of 4 elements. First policymakers sought to keep the budget deficit below 3 per cent of GDP. Second they wanted to maintain automatic stabilisers in the economy. Third, there was an attempt to improve efficiency by simplification of the tax system. Fourth, the Czech government aimed to reduce tax rates in order to make the economy more "competitive".

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The Martner and Tromben paper paints a vivid picture of the fragility of Latin American countries' public finances. A basic problem is the high instability of gdp, this naturally leads to unstable tax revenues. This instability has tended to lead to increasing debt burdens. Some countries have allowed debt to crescendo to the point that long run surpluses are needed into the future to service the debt, while several others face the need to maintain tight fiscal policies to avoid this situation. Mexico and Chile have been among the more successful countries. Their reduction of debt in the 1990s now allows some flexibility over fiscal policy.

The papers of this session, other papers of the conference and experience from the Baltic suggest a number of lessons for tax reform. The CIS experience suggests that fragmentation of tax collection may make it less effective. The dramatic tax reform in Russia under President Putin offers a fascinating case for analysis. So far it is still to early to tell whether the lower tax rates lowered tax evasion significantly, tax revenue rose for other reasons. One priority for reform that comes out strongly in the Baltic countries is the replacement of personal income tax by value added taxation, due to the latter's greater efficiency in collection. A lesson from reforms of the personal income tax in the UK is that reducing exemptions may harm political decision-making and hence it is better to reduce tax rates. Another policy reform idea with negative consequences is the abolition of corporate income tax. It is better to exempt dividends and capital gains to avoid double taxation, but retain the tax on profits to prevent earnings going untaxed.

In some areas of tax policy not enough is currently known about the current environment to create the most effective reform, particularly in the transition countries of Central and Eastern Europe. More research is needed particularly in the area of tax evasion. Questions such as how much evasion is achieved through non-registration of enterprises versus hidden payment of cash in envelopes by registered companies need to be investigated further. It may be possible to find evidence of evasion from clustering of declared income around the minimum wage in the wage distribution. This research could then provide the opportunity for cost/benefit analysis of administrative measures to combat evasion such as increasing quantity and quality of auditing.