

**STATE INSTITUTIONAL DEVELOPMENT:
ASSESSING THE SUCCESS OF THE PERUVIAN TAX REFORM**

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Democracy and macroeconomic policies have experienced a dramatic change in Latin America since the 1980s, and both have been extensively studied by scholars and policy analysts (Fishlow 1991; Smith, Acuña and Gamarra 1994; Chalmers et al 1997). However, the issue of state reform, one that strongly conditions the sustainability of the new regime and neoliberal policy trends, remains very much understudied. Lack of attention is perhaps explained by the fact that the reform efforts in the state apparatus are more difficult and less spectacular. Precisely for that reason, studies of state institutional development are much needed. The state apparatus has to be transformed in order to improve policy effectiveness and to establish a more positive relationship with civil society, two key elements to sustain growth and democracy.

Despite the slow and limited nature of state institutional development, there are some areas where the forces of change have been able to overcome the many obstacles that block the reform process, and upgrade the operational capacity of the state. This is the case of the tax administration, a branch that has recently become a fascinating and important experiment of state reform for a number of reasons. First, in order to succeed, and unlike other policy areas (i.e. trade), tax administrations have to change both the policies and the administrative capacities (Tanzi 1992). Second, fiscal stability is critical to sustain current stabilization and structural adjustment programs (World Bank 1991, Berenztein 1996). Third, the tax reform also positively changes the relationship between the state and civil society. Enhanced tax compliance, a goal of the reform, may help to strengthen the social pact established between the people and the government. Fourth, success is more easily measured in cases of tax reforms (increased tax collection) compared to other branches of the state. Fifth, thanks to repeated reform attempts in the tax administration, and increased scholarly attention, the dynamics of institutional change are now better known (Bird and Casanegra 1992, Blecher and Ke Young Chu 1989, World Bank 1991). Finally, there are some successful, well studied cases that provide an initial set of hypotheses to understand the specificities of institutional change.¹ All these

¹. SUNAT has published several documents that will be mentioned throughout the text. Some were presented to congresses organized by the Centro Interamericano de Administracion Tributaria (CIAT). Conference proceedings are regularly published by Instituto de Estudios Fiscales of Spain and CIAT. The author attended two of

elements can contribute to enhance the understanding of the state, an institution highly criticized and very little understood.

The case of Peru stands as one of the most comprehensive reforms ever achieved in the history of the Peruvian tax administration, outstanding also by Latin American standards (Thorp 1996: 34). During Fujimori's presidency (1990-2000), the *Superintendencia Nacional de Administracion Tributaria* (SUNAT), the agency in charge of tax collection, was deeply transformed. This transformation referred not only to tax policies (simplification of taxes, changes in the tax code, harmonization of taxes according to the new macroeconomic policy orientations) but to the administration itself. SUNAT was separated from the Ministry of Economy and Finance and directly linked to the presidency. Its political empowerment was complemented with the granting of financial and administrative autonomy. These factors were critical to assure the complete renovation of equipment and infrastructure, and to introduce radical changes in the area of human resources. The old traditional bureaucracy and predatory mafias were replaced a new generation of well selected, adequately trained administrators. As a consequence, policy efficacy dramatically improved, and the state could establish a more positive, consensual relationship with civil society.

Together with political support from the highest levels of the executive, congress, international organizations, and counting also with favorable public opinion and press coverage, the key factor to assure initial success was the cohesiveness and skills of a policy team. However, in the long-run clear limits to institutional reform both inside and outside the tax administration emerged. The combined influence of internal and external pressures to reduce the power of the tax administration and change tax policies more accordingly with civil society demands also made more difficult to sustain the reform effort. Finally, lack of reform in other key branches of the state apparatus also placed limits on the continuing advancement of the reform process. The paper, thus, identifies several stages of the reform process to increase state capacity through institutional renovation, and the changing relationship among key factors that influence the situation of a key branch of the state apparatus. In the end, SUNAT became an "island of efficiency" struggling to sustain the reform effort and waiting for the institutional renovation of the rest of the state apparatus.

these congresses: Santiago de Chile in 1993 and Lima in 1995.

1. Institutional Development

State institutional development is seen as a complex, long term process of change within the state apparatus, where opposing forces compete to direct and determine the direction of a bureaucratic body. If modernizers succeed in the power struggle, the state apparatus has a chance to develop a capacity to guarantee the efficient implementation of public policy. State capacity is sustained by a highly trained group of public servants with a strong sense of institutional identity. Institutional development is also "measured" by positive public opinion, a sign that the state apparatus has established a more positive connection with civil society.²

The approach used in this paper is more state-centered rather than society-centered because the tax reforms are largely the product of state elites. The policy teams, given a certain degree of political backing, enjoy the benefits of a "policy space." State elites, under specific circumstances, can guide reform efforts by estimating the cost of existing practice and assess, step by step, the choices and dilemmas necessary to modernize the bureaucracy (Grindle and Thomas 1991: 2-4; Silva 1996). The results of policy elite actions are seen in terms of institutional development. Consequently, more effective policy implementation follows. Both the context where decisions are taken and the nature of policy elites determine a path of institutional development that will have future consequences in terms of assuring the legacy of the modernization process.

Besides the role of policy elites, there are other factors that strongly condition their room to maneuver. First, the relationship between the tax agency and other key executive positions has to be supportive of institutional reform. Experts agree that a most crucial factor in any reform attempt is strong backing from the executive. Being the tax administration part of the "economic ministries," a positive relationship with the ministry in charge of economic affairs is also necessary in the long-run because presidential priority is subject to change without notice.

². This definition of institutional development blends ideas discussed by Glinder and Thomas (1991: 4) about the reform process of public institutions, and the concept of state efficacy developed by Peter Evans in his analysis of the Latin American state (1989: 1 and 26).

The analysis must also incorporate the way public opinion, the press, economic interest groups, and taxpayers of different categories, react to policy changes and institutional development. Emphasis on these factors is important since they are usually overlooked. Policy experts, for example, are highly knowledgeable about the internal workings of the state, but less aware of civil society, a factor that is viewed as "political" rather than "technical."³ In this sense, the study of institutional innovation in one branch of the state has to take into consideration how "embedded" the state apparatus is in its surrounding social context. This type of approach, similar to the one advocated by Peter Evans in his study of the Latin American state, places a strong emphasis on the dynamic process of change. A sequence of stages can be established by identifying different patterns of variable interactions. The dynamic perspective becomes critical to assess "how much" institutional development has in fact occurred, and how the reform process constantly struggles against factors and forces that oppose change. These constraints, located both inside and outside the state apparatus, are usually hidden in the early stages of the reform process, a fact that makes them hard to detect. A long-term perspective is thus necessary to make a more balanced assessment of institutional development.

2. From Developmentalist to Predatory State.

Before the successful reform attempt initiated in 1991, Peru had a huge state apparatus designed to provide a wide range of social services, and to stimulate industrial development through varied policy controls and numerous public companies. In 1989 it employed 1,070,000 people, (28 percent of the labor force in the modern sector), and owned 120 companies (Arias 1991: 201-202).

Inside the state apparatus, different standards of bureaucratic capacity generated a "segmented" state apparatus. Modern branches, also known as "islands of efficiency," (merit-based recruitment agencies, more effective and better funded than the rest), coexisted with traditional branches (overstaffed, underfunded, clientelistic and usually ineffective). Another dysfunctionality was also visible. Inside the traditional branches, an upper, professional bureaucracy (highly trained, appointed through a

³. Several studies on tax reforms in Latin America make occasional references to factors such as "government credibility," "favorable public opinion," "political interference." See Blecher and Chu 1989, Bird and Casanegra 1992.

formal selection process, better paid), led a mass of traditional, undertrained bureaucrats. As a result of this dual segmentation, two bureaucratic cultures (modern and traditional) existed inside the state, blocking the development of a full collective institutional capacity to design, implement, and evaluate public policy. The bureaucratic culture was autocratic and to concentrating power at the cost of institutional development. Traditional bureaucrats were particularly accustomed to using public resources for private purposes, to hiring personnel among relatives and friends. Predatory, corrupt bureaucrats exacerbated these traits and transformed the state apparatus in times of crisis in a "private enterprise" where "loses were socialized and profits privatized." Inefficiencies and lack of resources did not matter and actually provided a cover to hide abusive behavior. The modern bureaucratic culture had a stronger emphasis on professionalism, valued more communication among different units, and had a stronger sense of the national interest, although it was also accustomed to the idea of leading institutions through a "top-down" decision-making system.

Three circumstantial factors debilitated the capacity of the Peruvian state since the 1970s: a wave of economic recessions, pendular policy oscillations, and high levels of political violence. A fiscal crisis was already evident as early as 1976, a problem that continued to plague Peru until the early 1990s. Policy shifts indicated a political stalemate between competing forces. A pro-open market administration led by Fernando Belaunde was replaced in 1985, in the midst of a recession, by a pro-developmental administration led by Alan Garcia, who stayed in power until 1990 (Ortiz de Zevallos 1989: 2, Gonzales de Olarte 1991: 15, Lopez 1991: 207). Neither Belaunde nor Garcia could sustain the policy orientation. The former abandoned his economic plans after a depression in 1983, and the latter, after a brief bonanza period, suffered from a deep depression that forced him to adopt stabilization policies since 1988. To make matters worse, the decade of the 80s produced a wave of social movements and political violence that weakened the state. Labor strikes (both in public institutions and the private sector) and continuing social movements, became common place (Mauceri 1995: 10). In addition, two active guerrilla movements caused further unrest (Shining Path and Tupac Amaru Revolutionary Movement). Between 1980 and 1990, Peru suffered more than 20,000 casualties related to political violence. These three factors generated conditions for a continuing deterioration of the state's organizational structure and its

ability to influence societal actors.⁴

In this period, the tax administration became unable to identify the taxpayers, conduct basic auditing operations on a normal basis, and update archives. Lack of resources and a dramatic fall in wage earnings aggravated the situation. By early 1991, before the reform, average wages for the 3,025 tax administrators was US\$ 50, two thirds less than real wages obtained in 1970. Most employees were organized in labor unions and resorted to continuing strikes that accomplished short term wage increases (since hyperinflation soon eroded the gains). One year, the tax administration was paralyzed for five months by labor union strikes (Estela 1991: 4-5). Continuous paralyzation and low wages provoked the search for alternative income. About 25 percent of public employees had a second job in the private sector (Arias 1991: 202).

In this context of ongoing crisis, the developmentalist state rapidly degenerated into a predatory form. Bureaucratic mafias prospered and remained unpunished. Labor unionism and existing labor legislation was used as a protective shield by corrupt officials. Large taxpayers were targeted for abusive auditing operations designed to intimidate them and facilitate extortion. Small taxpayers regularly paid bribes to erase debts or avoid law enforcement against open tax evasion and fraud. When the task force took over the tax administration in early 1991, Manuel Estela, the team leader, described the deterioration of the state in the following terms:

When I asked to see the program to control tax returns, I had a severe depression. There was no program. They [the auditors] always checked the same people, whether they were relevant or not. In 1990, they did 700 full checks out of 200,000 tax returns. And the people checked were always the same because they had worked out an under-the-table payment scheme with guys earning \$30 a month (*The Wall Street Journal*, January 8, 1992: 4).

In part because of hyperinflation and in part because of institutional deterioration, the state suffered a dramatic loss of

⁴. Phillip Mauceri (1995: 11-12) analyzes the weakening of state capabilities in Peru caused by the economic crisis, the politicization of state bureaucracy, and terrorism. He does not mention the importance of the ongoing competition among policy-makers.

tax revenues. Higher tax rates were then introduced to cope with the fiscal crisis. In 1988 the rate for the sales tax was increased from 10 to 15 percent. When this source of revenue declined, excise taxes (gasoline, cigarretes, liquor) were prioritized (Arias 1991: 210, Thorp 1996: 36).

These emergency measures generated continuing complaints by taxpayers. Business associations got used to demand and obtain an extension of deadlines to pay the income tax. When the crisis reached a lower point, tax amnesties were also granted by a weak, isolated, unpopular administration. The rapid erosion of state authority was evident in the late 1980s. About 6 million people had a "libreta tributaria," which served as an ID and tax identification number. In 1990, only 13,482 people paid the sales tax (Arias 1991: 211). Existing legislation was a "legal jungle" (*maraña legal*), a complex, chaotic body of more than 180 different taxes and hundreds of regulatory measures that made administrative tasks and legal interpretation particularly difficult⁵. One of the paradoxes of the crisis is that guerrilla organizations became more efficient than the old state in collecting "revolutionary taxes." They developed forms of territorial control and the capacity to sanction tax "evaders" that the formal state lacked.

In sum, the main functions of a modern tax administration were crippled. The deterioration of state capacity and hyperinflation (consumer prices increased over 7,000 percent a year in 1990) deepened the fiscal crisis of the state. Tax revenues as a percentage of the GDP decreased from 15.6 percent in 1980 to 13.2 percent in 1985, and to 5.8 percent in 1989. At the moment of the initiation of the reform, in the first semester of 1991, it reached a low point of 4.9 percent (Estela 1991: 1).⁶

⁵. A tax lawyer from a top legal firm argued that "even me, an expert, cannot follow up with all these legislative changes." Personal interview, Lima, July 1993.

⁶. Hyperinflation also caused statistical problems, in particular with the GDP. For that reason, tax pressure (tax revenues as a percentage of the GDP), the main indicator, is not accurate for this period. Some critics argue that being the GDP overvalued, tax pressure is actually higher than what current statistics indicate.

3. Crisis-Ridden Tax Reform

The above section describes a situation of deep crisis that deteriorated the state apparatus and severely limited its ability to implement policy. Only with the perception of a serious crisis at the highest levels of the decision-making process, were the stakes high enough for the government to react. In that sense, SUNAT is a typical case of crisis-ridden reform initiated within the state (Grindle and Thomas 1991: 6; Bird and Casanegra 1992: 60).

Based on the Peruvian experience, graphic no. 1 presents an analytical model that takes into account a number of circumstances and key factors, both in state and civil society, that eventually made possible initial success and long-term institutional development. A different combination of factors and changing economic and political conditions in the late stages of the reform process prevented continuing progress.

Policy reformers in Latin America have considered agency autonomy and a significant increase in material resources as critical to transform the tax administrations before the reform takes off. Indeed, tax administrations, given the policy priority to generate state revenues, have usually been granted autonomy and special budget conditions. Separating the tax administration from the executive (the Ministry of Economy) is possible by transforming it into an autonomous agency (a superintendency) linked to the presidency. In addition, material resources can be increased by directly assigning a percentage of tax collection to the administration. In this scheme, if the reform succeeds, and given the fact that tax compliance is low, the superintendency will increase tax collection on a constant basis and self-generate the resources to hike wages, and modernize administrative systems.

This was the goal of a reform attempt initiated in Peru in mid-1988. The García government issued Law 24829 transforming the Dirección General de Contribuciones into SUNAT, and granting two percent of revenues (internal taxes) to the tax administration. These changes were not enough since the reform never took off.⁷ First, the policy team did not have the preparation to suggest policy and administrative changes needed to succeed. Second, the authority given by the president and by the Ministry of Economy and

⁷. For a discussion on tax reforms during the Garcia administration, see Vidal Henderson (1990).

Finance (MEF) was weak and lacked consistency. Third, the additional resources given to increase wages for tax officials still required special authorization by MEF, a ministry unreluctant to grant privileges to the tax administration, which still operated in MEF premises.⁸ Fourth, the García government attempted to combat hyperinflation and recession without any coherent economic plan. The tax reform was vaguely stated and the elimination of populist tax legislation was ruled out.

The failure of earlier reforms provoked internal bureaucratic responses that made the prospects of change more difficult. The predatory bureaucrats took advantage of increased institutional weakness to organize internal mafias. To make matters worse, their actions, in most of the cases, remained unpunished.⁹ During reform attempts, the mafias initially lowered their heads and later reemerged with renewed strength while traditional honest bureaucrats retreated to defensive positions, and the leading reformers resigned.¹⁰

4. Stages and variables.

A dynamic perspective helps to explain in detail the sequence of institutional change from the onset of the reform process, and allows a more specific identification of the way variables are combined at different stages. Three distinct stages are identified in the Peruvian reform. Stage I is defined by the initiation of crisis-ridden reform process led by a task force of policy makers. The context of severe economic crisis makes fiscal stability a

⁸. For that reason, SUNAT documents distinguish between formal and real autonomy. See SUNAT (1993).

⁹. One of these scams was discovered years later. Taxes paid to Banco de la Nación were appropriated by bank officials and tax administrators who forged documents. Since the computerized and registry systems did not work, inefficiency prevented crime prevention. Only when the systems were set up, the remaining mafia members were identify and prosecuted.

¹⁰. The assessment of earlier reform attempts owes much to conversations with Esteban Pavletich that took place in 1996. Pavletich was a former director of the Direccion General de Ingresos in the 1970s. He resigned in 1986 after attempting to reform the tax administration.

major policy priority that triggers a reform attempt supported by top executive decision-makers. Stage II is characterized by institutional consolidation led by the policy elites capable to face and neutralize internal and external forces opposed to change. Stage III is a process of bureaucratic "normalization," a situation where the reform process prevails but some factors place limits to the continuity of institutional development.

Three possible outcomes are likely to occur in future stages of the reform process depending on the strength of the pro-reform forces. One scenario is that of an "island of efficiency," an agency strong enough to remain modern, but isolated from the more traditional branches of the state apparatus. Another more optimistic scenario will occur if the reform is replicated in other agencies and the whole state apparatus moves gradually in the direction of institutional change. Finally, a pessimistic scenario will occur if the reform slows down, bureaucratic dysfunctions emerge again, and the reform process is abandoned altogether. This is a case of bureaucratic regression.

The factors that can sustain and extend the reform effort to create an "island of efficiency" and, if possible, initiate a generalized process of institutional change, are as follows. Political support from the top is considered by most analysts and policy makers as a critical factor (Bird and Casanegra 1992: 4, Radano 1994: 3, Arias 1994, Marcel 1996: 9). If the president and other higher authorities (particularly the Ministry of Economy and its economic policy team. Congressional support can be critical when legal changes are needed) do not sustain change, the reform process will gradually lose its initial impetus.

Successful reform and sustainability also depend greatly on the quality and the cohesion of the policy team. The team has to possess both strong technical skills and acute political instincts. Support from international organizations is important to innovate administrative systems, but should not replace local experts. To succeed, the reform proposal must have "domestic ownership," which implies that local policy elites have to be able to devise, carry out, and evaluate policy plans (World Bank 1991: 62).

Strong leadership and team work help the policy team to make better choices. This is the basis of the task force model for state reform. Early success generates much needed credibility, which in turn enhances the room to maneuver. The team's technical and political skills are indispensable since prudence and sound opinions are needed to deal with the executive, congress, public

opinion, and taxpayers. At the same time, the team has to be daring enough to defeat or neutralize the many forces that oppose the reform. As a rule, the weaker the institution, the more important the quality of the task force and good leadership.

A key factor to assure continuity is an in-depth renovation of the state bureaucracy. A Weberian leap to achieve a higher stage of bureaucratic development can only be accomplished by institutionalizing modern recruitment, promotional, and appointment procedures. This is a major challenge. Very few tax administrations in Latin America have been able to consistently adopt comprehensive and modern human resource policies. If key decisions are not taken (the removal of bureaucratic mafias and traditional bureaucrats, the promotion of well trained, honest and experienced bureaucrats; the recruitment of a new generation of professionals) and fully implemented, the most likely scenario will be a pessimistic one. Put differently, if human resources are not prioritized, the likelihood of institutional regression is higher.

Success in the long-run also depends on establishing a positive connection with civil society. A high degree of consensus in favor of the reform is needed to lower the cost of a "tax rebellion" that will inevitably emerge. The government as a whole has to face the problem of keeping the goals of the reform and at the same time dealing with an inevitable wave of demands to adjust, change the tax system (Bird and Casanegra 1992: 9; Silvani 1993: 2; Marcel 1996: 15). In this period, the agency has to become insulated to negative and corruptive influences coming from civil society and the state, and efficient enough to satisfy the public needs on adequate information and services.

Factors that contribute to the achievement of institutional development depend on often elusive contextual variables such as sustained economic growth and political stability. Economic growth will reduce the tensions of redistributive wars and tranquilize taxpayers, in particular those who suddenly are forced to comply with the law. Political stability will guarantee the continuity of reform efforts under several administrations.¹¹ In general, there is no doubt that putting all these different factors together is quite a difficult. Only in exceptional cases, all factors are

¹¹. The analysis of some cases (Bolivia in the late 1980s, Nicaragua in the mid 1990s) indicates that a serious problem for long-term development is that upcoming administrations do not continue to sustain the reform efforts.

favorable to the reform process. That is why in the Peruvian case, the SUNAT leaders were thankful that at least in the first years "all the planets were correctly aligned."

5. Measuring success

The policy success of stronger state institutions in charge of tax collection is basically measured by an expansion of the tax base, active law enforcement and, as a consequence of these changes, increased tax revenues. Several factors also influence changes of this basic indicator (growth and inflation rates, legal changes, taxpayers' behavior), but in general a tax reform usually raises revenues immediately and, more importantly, helps to sustain it in the long run. If the tax reform comes at a time when inflation is being controlled, price normalization does decisively help to increase tax collection, but it has a short-term effect since taxpayers' behavior has not changed. This paper emphatically argues that, provided economic and political conditions are normal, only an overall tax reform can induce a significant increase in tax collection in the long run.

The most obvious indicator of success in the Peruvian tax reform of the 1990s is that tax revenue as a percent of GDP rose from less than 5 percent in the first semester of 1991 to 11 percent in 1993, and 14 percent in 1995 (Thorp 1996, *Gestión* February 22 1996: 10). The increase in tax collection was sustained by the continuing application of sanctions, and the rising numbers of registered taxpayers (expansion of the tax base) and tax returns filed. The number of stores closed by SUNAT (a sanction against stores who evade the sales tax or do not comply with the tax code) rose from 620 in 1991 to 5,319 in 1992; 7,910 in 1993, and 7,268 in 1994.¹² The number of registered taxpayers (a computerized tax registry system was created in 1992) rose from 80,000 in 1991 to approximately 300,000 active taxpayers in 1994. 200,000 more were included in the system as irregular taxpayers. The number of large taxpayers increased from 700 to 9,216 in 1993 (representing 85.5 percent of sales tax collection). The number of income tax returns filed passed from less than 200,000 in 1991 to 227,519 in 1993, and 423,444 in 1994. The ratio of income tax returns filed per inhabitant grew from 0.72 in 1983 to 18.64 in 1994, an indication that the tax reform had a higher efficiency than that of previous administrations in the early 1980s when tax revenues had not yet

¹². SUNAT data. "Memoria 1994 de la unidad de clausura y sancion." Lima, SUNAT 1994.

dramatically declined (Arias 1994: 2 and ff.).

The tax reform almost immediately generated public recognition. Its actions, originally centered in Lima, were soon extended to the rest of the country. In 1993, 73.8 percent of taxpayers from ten cities considered that SUNAT was "improving as an institution," while only 8.1 percent thought it was "worsening."¹³ The SUNAT reform was considered by 1994 as the third "most positive aspect of the Fujimori administration" by Peru's leading polling firm (being the first the fight against terrorism and hyperinflation) (Apoyo, "Informe de opinion" July 1994: 23). Another poll on corruption in public institutions taken in 1995 indicated strong public recognition of the reform effort. Only 1.3 percent of those interviewed in Lima considered SUNAT "corrupt," while 52.9 percent considered the police the "most corrupt institution," followed by the judicial system (40.2 percent) (*La República* March 2, 1995: 20).

Changes in perception inside the tax administration were also remarkable. A 1995 internal study conducted by the Institute for Tax Administration (the training and study center of SUNAT) revealed a rather unusual situation: 9 out of 10 employees were satisfied with working conditions (47.9 percent of the personnel were "highly satisfied" and 49.1 percent were "satisfied"). Only a minority, 3 percent, believe they were "not satisfied."

6. Stage I of institutional development

In stage I, the central actors are the state and international organizations. Civil society is in a dormant state, unaware of the process that is about to take place. At the center stage is the task force. The different bureaucratic factions (modern, traditional, predatory) play a wait and see game since they can only react to initiatives taken elsewhere.

In 1990, Alberto Fujimori came to power in the midst of the most serious depression of the century. The situation, politically and financially, was chaotic and desperate. One of his first executive decisions was to embrace free market policies and obtain support from international financial organizations. Alberto Fujimori and his inner *nisei* circle (in particular his younger brother Santiago Fujimori, a lawyer and his main advisor) were convinced of the need to stop corruption and reform some agencies in order to reestablish

¹³. Data from the Institute of Tax Administration, SUNAT.

state authority and succeed with the economic stabilization plan.

¹⁴ This approach to both administrative and policy reform (being the latter changes in the tax system to harmonize taxes with economic liberalization policies) were also supported by the Ministry of Economy and Finance, Carlos Boloña.¹⁵

The task force, known as "the team" (*el equipo*), relied on three important elements of strategy development to unleash the reform process: Trust and team building, goals and planning, and the role of external advisors (Thorp 1996: 36). Based on these elements, and initial success, political backing to the policy team was guaranteed. Manuel Estela, a former manager of Economic Studies at the Central Reserve Bank, familiarized with fiscal policy in previous years, was nominated National Superintendente in May 1991. He was instructed to lead a team of national and international experts, propose a comprehensive reform proposal, and attempt to transform SUNAT into a model institution. Most of the task force put together by Estela and Luis Alberto Arias came from the Central Reserve Bank, the sole public sector institution which had a strong and relatively undamaged professional tradition. In addition, most top members came from a handful of private universities (Catholic University of Peru, University of Lima) and had a multidisciplinary expertise. The team's trust was developed thanks to this common background, and soon extended to other members, including a select and honest group of tax administrators and MEF officials familiarized with the twisted logic of Peruvian bureaucracy. All brought diverse experiences and professional skills (law, accounting, economics, taxation, public administration, sociology) and were truly committed to the idea of *reforma tributaria*. This

¹⁴. According to Estela, Fujimori considered the tax reform a high policy priority. An increase in tax collection was seen as critical to the success of the economic stabilization plan to cope with inflation. In May 1991, when Fujimori persuaded Estela to organize a task force, he told him "this is a matter of the utmost importance and I will be personally involved." Personal interview with Estela, Lima, April 7, 1997.

¹⁵ Policy experts agree that the distinction between policy and administrative changes is of little relevance in practice because both strongly influence one another. The simplification of the tax system (reduced number of taxes) and the extension of the tax base do not yield any significant result unless administrative systems are introduced and administrators are knowledgeable enough to operate them efficiently.

was the main mean by which a "principal agent" problem, the downfall of the previous administration, was resolved.

The "master plan" (as Estela liked to call it) was developed as a joint effort of national and international experts (the latter with a previous experience with tax reforms in Latin America).¹⁶ Final decisions were made by the local team. The plan advocated a radical transformation of the administration given the degree of deterioration and the urgency of meeting fiscal targets. The idea was to set strong initial conditions for positive "path dependence," hoping that the enemies of the reform will be so severely defeated that continuing institutional development was likely to occur.¹⁷ Given the nature of Peruvian politics (a place where "all temporary decisions become permanent" because powerful coalitions defend a established path) the incremental, step by step reform approach (actually the one recommended by international experts) was ruled out by the local team. The reason is that previous reform efforts showed that the forces oppose to the reform tend to hide themselves, and gradually resist reform efforts until political backing erodes and internal support loses steam. Then the reform is reversed. The task force was fully aware of this challenge. That is, the most important resistance to reform efforts had to be neutralized right from the start.

Special authority was needed to move the premises to a larger, more modern building, evaluate the personnel, and fire employees who did not pass an exam (provided by outside educational institutions, to assure neutrality) or who were known to be corrupt. New sanctions were demanded to penalize tax evasion. In addition, financial

¹⁶. In an interview with Manuel Estela (Lima, April 5, 1997), he asserted that while working at the Ministry of Economy in the 1980s, he and Luis Alberto Arias collaborated to draft a plan to reform the tax administration. This was an important previous experience "because we already knew what to do." Alberto Radano and Alberto Conde were tax administrators in their home country of Argentina and experienced international consultants, who supported the tax reform process in Bolivia and Paraguay before coming to Peru.

¹⁷. On the issue of path dependence and institutional change, see David (1994).

autonomy without controls from MEF were also demanded.¹⁸ Having in mind the Central Bank as a model, the proposal was to introduce modern recruitment policies and hike wages to levels similar to those of the monetary institution.

This plan was discussed with the Fujimori brothers, in particular with Santiago, who collaborated in suggesting legal changes and gave ample advice on what was politically feasible. The president supported it since the plan was consistent and detailed enough as to accomplishing a major transformation of the tax administration. One key element in gaining presidential support was Estela's "political" argument that the reform about to take place could be credited to his administration. The plan, once approved by the president and MEF, was presented to the Congress. This was a necessary step, given the fact that at the beginning of the Fujimori administration, the executive was weak and the president had no congressional majority. The solidity of the plan and the team's high degree of technical expertise assured a balanced, productive dialogue with key congressional committees, all concerned with the fiscal crisis and the deterioration of the state apparatus. Although some senators objected to the drastic labor measures to be taken and to the inevitable privileges granted to tax administrators, at the end, Congress provided multi-party support in early 1991.

Once the team obtained solid political backing, implementation began. The goal was to induce drastic change and use the surprise element to push the reform process forward and defeat any resistance. A task force comprised of both new and old administrators committed to the reform process (a key ingredient for success) was determined to take over the old SUNAT and quickly transform it into a modern superintendency. Changes in the bureaucratic structure and reduction in the number of employees had to be accomplished in the face of opposition from the bureaucratic mafias, the labor unions, traditional bureaucrats afraid of change, and even terrorist organizations. At the same time, collaboration of honest employees was needed in the selection process to remove the bad apples and keep the good ones. An error of judgement in

¹⁸. According to Estela, he was designated Superintendent by the President himself, a decision basically rubberstamped by Carlos Boloña the Ministry of Economy and Finance, who was appointed at the same time as Estela. The tax reform started without any dependence to an executive position other than the President. Personal interview, Lima, April 7, 1997.

this sense would have been fatal. Once changes were announced, the task force met its first and perhaps toughest challenge. In mid-1991, labor unions immediately organized mass demonstrations and strikes against the evaluation process and the removal of the tax administration to new premises.¹⁹ Predatory bureaucrats operating behind the scene supported union resistance and helped organize a wild strike. In the midst of labor union mobilization, a terrorist group launched a small rocket against the premises of the old tax administration (floor thirteen of MEF premises). The team, however, held their ground until a small but growing number of employees began to accept the reform proposal. Material benefits were also being considered. At the end, early retirement and extra benefits to those to be laid off, plus a US\$50 bonus to those who took the test, provided enough stimulus to gather support for the reform. One third of the labor force remained employed (991 out of 3,025). The rest (2,124) accepted retirement benefits and resigned (at a cost of US\$2'307,000 as retirement compensation) (Arias 1994: 3).

Once the reform took off, congress immediately passed a law authorizing SUNAT to have private sector wages. Employees went from an average monthly rate of US\$50 to US\$890, a fact that boosted morale of the old labor force. Moving to new premises, a modern thirteen story building, despite union opposition, was also critical since SUNAT operated in a cramped, deteriorated building without computers and with a reduced fleet of old VW vehicles. The struggle within the state, the first trench to be taken, was won. From then on, the SUNAT policy team was legitimated internally and externally, a fact that assured the policy space needed to implement other changes. Initial success generated a skier mentality, to move downhill faster, given the fact that the initial push was so strong.

As soon as the initial period of change ended, SUNAT focused on tax collection increases and law enforcement, two particularly difficult tasks. Here the audacity and the wisdom of the policy team became a key factor. Law enforcement was combined with an effective ad campaign and extensive press coverage in order to balance coercion with effective communication. Since at the beginning administrative capacity was almost nil, the policy team devised a "fire cracker" strategy to "make noise" for a while. The

¹⁹. The team was at one point barricaded in the Superintendent's office, surrounded by demonstrators who threatened to enter by force. A special police unit sent by the president had to tear gas the building to liberate them.

idea was to let taxpayers of all categories feel the presence of the tax administration (that is, increase the risk of evasion) and win time to install modern administrative systems. Massive auditing programs (possible thanks to congressional approval of a system to monitor commercial firms), combined with selective ones, were introduced for that purpose. Young university recruits, well dressed and mannered, were carefully chosen to visit commercial establishments in the main cities to look for tax abuses. If tax evasion was spotted, the stores were closed for a week. This was the first signal that the administration meant business. Tax evasion was so evident and generalized, the army of *fedatarios* (derived from the Spanish word *dar fe*, to give faith) was so effective, that soon hundreds of stores were sanctioned without much reaction. The business sector was caught by surprise. Inept or corrupt accountants were fired, demand for tax consultants increased, information was requested, and the media started to report positively on an innovative and spotless tax revolution. Like in a military operation, intelligence teams were formed to study cases and identify areas where contraband and open tax evasion was concentrated. Army support was granted by the president (the police could not be trusted) to provide protection to secretly planned operations (*Caretas* November 25, 1991: 26-28). In December 1991, *Operacion Pastorcitos* targeted the Polvos Azules informal market located one block from the presidential palace. The market, a center of contraband, was intervened by hundreds of SUNAT auditors, aided by soldiers and a team of special prosecutors, who proceeded to organize a massive merchandise inventory (*Washington Post*, December 26, 1991, section D, page 2).

These operations became both a policy and a media success since for the first time open tax evasion was being fought. The operatives introduced a sense of order that was welcomed by the population, now passing through a more conservative mood. Sanctions, more importantly, were also accepted by surprised tax evaders who never realized that state authority could be fully exercised. The restoration of authority was also important because several businesses regularly paid "cupos" (protection money) to the Shining Path. If the state recovered its authority and provided protection, citizens could "normalize" tax compliance. The audacity of this tactic was coupled with operatives to touch other social segments, big business in particular. The most remarkable case was the closure of the luxurious Hotel Cesars for ten days, despite tremendous private pressure from the owner, for irregularities in its income declaration. A few days later, 17 fashionable restaurants and night clubs around Lima were warned they should be closed unless they presented receipts. Other spectacular cases

followed. A well known senator, Ricardo Vega (former president of CONFIEP, the peak business association) was sanctioned for not paying income taxes according to the deadlines. The same sanction was applied to other congresspersons and relatives of political leaders. The concert of a famous *merengue* band was checked by a small army of auditors who collected all tickets at the gates of Lima's biggest stadium. Police officers tried to prevent the operation until a call from the presidential palace harshly ordered their commander to let SUNAT auditors enter the stadium.

In this critical moment, when state action touched interest groups, two elements provided enough support to legitimize auditing tactics. The first was the degree of presidential support. In this sense, the Peruvian case is rather exceptional, given the high degree of insulation of Fujimori's inner circle, and the lack of compromises with special interests.²⁰ The 1990 election was won by Fujimori without massive contributions by private donors. The fact that the press and public opinion supported the operatives helped to isolate the critics and neutralize the defensive mechanisms generated by those sanctioned (who often complained in the press about "abuses"). Communication added the second ingredient. The ad campaign and an intelligent public relations strategy devised by a media expert (Oscar Dufour from Interandina de Publicidad) helped to legitimize the reform efforts. Private meetings between Estela's team and top business people, including representatives from the peak business association (led at that time by Jorge Camet, later designated Minister of Finance), helped to explain to community leaders in detail the logic of the auditing process and the larger goals of the reform.

Last but not least, SUNAT also had to face the challenge of terrorist organizations.²¹ The most daring and devastating attack was launched by the Shining Path a Friday night (9 pm) in May 1992, when a bomb exploded at SUNAT's headquarters, a recently acquired building. Although SUNAT did not suffer human casualties, the bomb destroyed

²⁰. According to Estela, when he asked if the executive would support auditing measures that touched powerful interests, Fujimori replied "I do not have any compromises, and you?" Personal interview, Lima, April 7, 1997.

²¹. In an interview with a leftist political leader, I was told that Abimael Guzman wanted the SUNAT reform to stop because it was a sign of state recovery. Estela had similar information from the secret service. Personal interview, Lima, June 1992.

part of the building and most of the electronic equipment. The policy team was tested once more. By the next day, soldier and crews comprised by volunteers initiated a clean up operation and SUNAT opened its doors again to the public by next Monday. Meanwhile the executive authorized special funds to rebuild the premises and acquire state of the art computer facilities. Although other attacks continued, forcing SUNAT to adopt strict security measures, the threat was also successfully faced.²² The attacks created a mystique among employees, and added another element of trust and commitment to continue with the reform efforts.

7. Stage II

The consolidation of the reform process was possible because the policy space generated in stage I was solid enough to develop conditions to institutionalize the reform. Given the fact that increased tax revenues automatically translated into a larger budget, lack of resources was not an obstacle. The policy team had the chance to introduce vast administrative changes and a modern merit-based human resources policy. On this basis, the durability of success was assured at least for the coming years.

Administrative changes were developed by joint teams of local and international experts who presented proposals to the *Comite de Alta Direccion*, where all intendents and top advisors participated in meetings (every Wednesday, all day long) to evaluate the implementation of the master plan and assess external circumstantial factors. The *Comite* openly discussed the feasibility of technical change and the possible consequences of reforms within the state and in civil society. Open debates on policy and political matters were particularly important to decide the best possible course of action since in most cases SUNAT was moving into uncharted territories. Three sequential plans were developed: first, a plan to recruit, train and promote personnel; second, a computerized system to efficiently gather and process data on taxpayers, tax collection, and auditing operations that could help elaborate annual plans; third, the establishment of a positive state/taxpayer relationship based on information, honesty and efficiency, but insulated to clientelism, and determined to implement sanctions when the law was broken (Estela 1996: 3).

²². Other attacks included bombs and armed attacks against the intendencies of Arequipa and San Martin. The Huanuco intendent was killed. The Shining Path infiltrated SUNAT in 1996 but the secret service was able to detect it on time.

The modernization of human resources became possible thanks to the decisive support from the top (inside and outside SUNAT), and the close coordination between the personnel manager and the training center, the Institute for Tax Administration (IAT). Between 1992 and 1993, SUNAT attracted thousands of applicants from the best universities (top third of the class). The selection process included newspaper ads that invited all applicants to pass several multiple choice exams, and after a first cut was made based on performance, in-depth interviews. In the first three years of the reform, 647 were recruited out of 15,410 applicants (less than 3 percent). To avoid any interference (internal and external pressure to "recommend" applicants), IAT insulated itself and created strict standards of admission. Once recruited, applicants were trained in courses specialized on legal matters, auditing, tax collection, computerized systems, and ethics. According to SUNAT sources, between 1992 and 1996, IAT offered 32 basic training courses to 1,114 professionals (new and old); 281 ethic seminars were given to almost all employees. Special auditing courses and middle-management courses were also taught on a regular basis.

The institutional administrative modernization plan was based on three "basic systems" installed thanks to the support of the Interamerican Development Bank, and the Interamerican Center of Tax Administrators (CIAT), which provided both funds and expertise. The first system was a new computerized registry of taxpayers (Registro Unico de Contribuyents, RUC). The second was a differentiated auditing system. A dual structure was created inside every intendency and local tax office. Main taxpayers were monitored by a special unit to assure the continuing increase of tax revenues, and the rest by regular units. Main taxpayers paid taxes directly at SUNAT premises, while the rest paid taxes in a newly created private banking network of 1,100 bank offices set up to break the monopoly held by the inefficient and highly corrupt Banco de la Nacion (Arias 1994: 7). With these two systems and the banking network, data analysis made possible the follow-up of collection trends and aided in the planning of auditing operations. The third system was the reorganization of sale receipts, crucial to sustain increased tax revenues and generalize respect for the tax administration. Cross examination of sales receipts from buyers and sellers, combining all systems, became a leap forward in terms of facilitating auditing operations and monitoring tax compliance. It is important to note that these systems could operate more efficiently thanks to the simplification of the tax structure. The number of taxes was reduced to five (value added, income, assets, excise, and housing and urban planning taxes; the latter known as FONAVI) and the main source of tax collection came from the sales

tax, representing 44 percent of all revenues in 1994. This was the first time since the fiscal crisis started that main revenues came from a source other than the gasoline tax. The institutional administrative renovation was completed with better infrastructure. The budget increased from US\$2,470,000 in 1991 to US\$10,000,961 in 1992 (SUNAT 1993: 12). In addition, all offices across the national territory were moved to new buildings with computerized systems. The latter implied that the reform, unlike other branches of the state, were being institutionalized at the national level.²³

The plan to enhance law enforcement was, without question, the hardest to be established on a permanent basis. The goal was to combine clear rules and strict application of sanctions with good relations with taxpayers (guaranteeing effective communication, neutral application of technical procedures, information on taxpayers rights and obligations, professionalism in handling taxpayers demands) (Estela 1996: 3). Respect for the rule of law was initially established by the "fire cracker" operatives. However, once the systems were set up, and the tax administration realized the extent of tax debts owed by taxpayers of all categories, a special amnesty was granted. If the taxpayer complied with laws and regulations from the outset of the reform, all past debts were to be erased ("*de aqui en adelante*" policy). If the taxpayer showed negative behavior, tax auditing would consider all accumulated debts. If the taxpayer was unable to pay the debt, depending on his financial situation, the amount owed was fragmented until fully paid. If, finally, the taxpayer resisted compliance, full law enforcement was imposed: Embargoes on assets, and lawsuits for criminal behavior in fraud cases.

To avoid the possibility of regenerating clientelistic/corrupt practices, auditors were instructed not to accept anything from taxpayers (including a glass of water). If caught receiving bribes, they were automatically fired and prosecuted in court. SUNAT issued a regulation in which all gifts sent on Christmas were systematically returned. These anti-corruption regulations also generated a new image, a recognition of good behavior that became the trademark of the new tax administrators.

²³ SUNAT became not only one of the most modern public sector institutions, but also one of the few that was equally modern at the national level, another accomplishment. SUNAT ended an era of centralization where only offices located in the capital city, Lima, had adequate infrastructure.

Communicating information about changing legislation and new rules became a major task to improve relations with taxpayers. A new information center was created in downtown Lima (Plaza SUNAT), where specially trained personnel registered new taxpayers, answered questions, and handed in thousands of brochures to the public. To enhance communication, IAT created two informational tools. The first was a monthly bulletin (*Tributemos*) mailed free to any taxpayer who requested it. Circulation passed from 1,000 in 1992 to 5,000 in 1994. The second was the organization of Tax Fairs across the national territory (*Sunathones*) to reach out small taxpayers. In addition, the ad campaign and informational brochures distributed by major newspapers completed the communications strategy.

The consolidation process in stage II was basically developed thanks to the policy space acquired, and the planning, operational and political capabilities of the policy team. In this stage, most of the obstacles to continuing institutional development were under control. The approval ratings of public opinion polls were a recognition of this effort, and a fact that guaranteed continued political backing, particularly from the president.

8. Stage III

The consolidation process is followed by a period where bureaucratic life is normalized and the dangers to continuing institutional development, or even regression, emerge. Less favorable conditions were generated within the state, inside the tax administration and in terms of the relationship with key branches of the executive. Taxpayers' reactions to what was considered "excessive" tax pressure also placed limits. The overall economic and political context became less favorable to increased tax collection. In general, policy efficacy tended to diminish.

The first factor that slowed down the reform were constant changes in the team's leadership. The SUNAT director is like a czar, with strong internal powers and in theory accountable only to the president. The institution is, thus, highly dependent on leadership, specially in the early stages because it does not have the time to develop norms and conventions that help regulate behavior. In six years (1991-1997), SUNAT had four directors. Some of these changes led to a gradual loss of institutional cohesion and a sense of esprit de corps. When Estela left SUNAT to hold a position in Washington, the idea was to keep the policy team intact and strengthen the reform efforts. In December 1993, Sandro Fuentes, the legal advisor, became the new director. Fuentes

maintained the policy team, but had a different vision of how to run the institution. Since the Comité de Alta Dirección limited its room for maneuvering, Fuentes started to diminish the number of sessions and control the agenda, instead of the open, intense, once-a-week meetings established by Estela. Fuentes resigned two years later and was replaced in April 1995 by Adrian Revilla, a lawyer from the Central Reserve Bank. During Revilla's administration, the cohesion of the policy team and SUNAT's esprit de corps greatly diminished when Luis Alberto Arias, Adjunct Superintendent, was abruptly forced to resign in July 1995, a decision wholeheartedly supported by the Minister of Economy and Finance (*El Comercio* July 16, 1995). Further changes were introduced when other resignations followed and newcomers close to the Superintendent were appointed by top-down decisions taken without consultation. Immediately after Arias' resignation, the new director changed the internal organization, eliminating the key Adjunct Superintendency and creating more intendencias (*El Peruano* July 20, 1995). With these changes, all intendents responded directly to the Superintendent, who concentrated two critical roles that proved difficult to combine: external relations and technical internal leadership. The corporate identity generated around the reform was also modified by the introduction of a new administrative theory, Total Quality Management, in vogue at that time. The idea of *reforma tributaria* was replaced by a philosophy that described taxpayers as "clients" to be respectfully treated. The new approach confused tax administrators, specially auditors, because they were convinced that the state rather than the taxpayers was the true "client."

Changes in the state's internal balance of forces became less favorable to SUNAT. When Estela left in late 1992, the Ministry of Economy and Finance, business leader Jorge Camet, tried to increase MEF's influence on SUNAT. The balance gradually shifted in favor of MEF, a ministry that felt that SUNAT had too much power and influence on tax policy making. Under Camet's reign, technical consultation diminished, and key changes in the policy team were induced for no apparent reasons.

The MEF offensive to return to a previous situation of control over the tax administration did not take SUNAT by surprise. Indeed, in mid 1992 a MEF project presented to a cabinet meeting attempted to eliminate SUNAT's financial autonomy. MEF argued that there should be only "one cash register" (*caja unica*) and SUNAT should be no exception to the rule. The project was dropped when Estela threatened to resign. In this conflict, the Fujimori brothers intermediated to avoid a clash of those two powerful agencies. When

Sandro Fuentes came to direct SUNAT, the delicate balance of forces within the state was somehow kept thanks to the influence of Santiago Fujimori, who served as the main liaison with the president, and tried to contain MEF's influence on presidential politics and SUNAT.²⁴ When the third change took place, and Revilla assumed the direction in 1995, the balance of forces shifted more definitely in favor of MEF. Several factors account for this situation. The most important one is that MEF became a much more powerful ministry during the 1995 elections. After the elections, Santiago Fujimori withdrew as the main presidential advisor in 1996, a decision that made contact with the presidency less frequent and more difficult. With reduced presidential backing and more difficult access to the presidential palace, SUNAT was very much "left alone flying in the wind."²⁵ When the fourth change in leadership took place in February 1997, SUNAT tried to resume the course of institutional consolidation. At this time, new organizational changes followed and Total Quality Management theory was abandoned.

Although some of these factors began to negatively influence the reform process, the loss of momentum described above, paradoxically, was little known to taxpayers. SUNAT's prestige was so solid and its accomplishments so evident that taxpayers remained largely unaware of the normalization process of politics-as-usual. Taxpayers of all strata still retained the perception of "Super SUNAT," and renewed their efforts to ease the tax burden by influencing the Fujimori administration, the new congress, and in particular MEF, now led by a businessman (in theory more sensible to their demands).²⁶ SUNAT's diminished ability to contact business leaders and improve informal communication with top taxpayers further stimulated business tax activism. Complaints about SUNAT's insulation were constantly made public by the major trade

²⁴. Fuentes followed a more cautious approach than Estela. When he voluntarily resigned, he advised Revilla "to be very careful, because SUNAT has made significant progress and each step has to be carefully taken." (*Solo Negocios*, August 29, 1996: 14).

²⁵. In the Santiago CIAT conference of 1993, the author asked the IRS Acting Commissioner, Mr. Dolan, what he thought about the autonomy of Latin American tax administrations. Dolan answered that he did not want the IRS to be left alone flying in the wind.

²⁶. Personal interview with Eduardo de Voto, manager of CONFIEP. Lima, August 1995.

associations and CONFIEP, the peak association. The pro-business approach of the second Fujimori administration created a more fruitful environment to channel business demands. Some of these demands were quite reasonable, since tax rates were high and several aspects of tax legislation needed to be adjusted. Others simply attempted to obtain selective exoneration by political means, which posed a danger to the reform, strongly geared toward tax simplification and strict tax compliance.

The first strong reaction came in 1993 when two general strikes were successfully organized by market vendors mobilized against the sales tax and application of sanctions (*El Comercio* July 20, 1993). Leaders from Federacion de Trabajadores de Mercados argued that poor people should not pay taxes because they were already heavily taxed by the municipalities. Rural products, they insisted, should be exempted because they were "perishable," a factor that increased risk for farmers. At the end, the government decided to exonerate rural produce from the sales tax (Decree 103-PCM/93) and SUNAT was advised SUNAT not to audit the markets in poor areas until political conditions improved.²⁷ These decisions placed limits to the expansion of the tax base.

Organized pressure by the main trade associations led by big business adopted more sophisticated, less visible, but more effective pressure tactics. Business interests were particularly emphatic in demanding the elimination of a two percent tax on assets (claiming it was "anti-technical"). Additionally, business trade associations complained that the tax burden was excessive and demanded lower tax rates.²⁸ Pressures for changes in the tax system increased as economic growth slowed down in late 1995 and early 1996. In 1996, several governmental decisions indicated that the government was more open to business demands. The tax rate on

²⁷. Sensing the possibility of tax exonerations, chicken farms, a highly profitable semi-urban activity, also argued that their products were "perishable" and should be exonerated. Congress leaders such as Jorge Larrabure, member of the pro-Fujimori coalition, was particularly supportive of chicken farms' demands. Meat producers sided with the proposal.

²⁸ Arturo Woodman, a manager of the powerful Romero family conglomerate, headed CONFIEP in 1995. Woodman declared that taxing assets should apply only to profitable firms. (*Sintesis*, April 10, 1995: 17).

assets was reduced from 2 to 1.5 percent (a loss of tax revenues estimated US\$60 million a year) (DL No. 881/08/11/96) (*Gestion*, November 15, 1996: 1). Several exonerations were conceded to specific sectors (to publications, in order to promote culture; to the construction sector, given its impact on employment; to agribusiness and tourism, to stimulate investments in rural areas and provincial cities) (Decree Law 818 and 885). Special tax contracts were signed with multinational corporations. The tax code modified by MEF (having obtained special legislative powers from congress), limited SUNAT's power to sanction tax evasion. This movement was crowned in late 1996 when a wide amnesty was approved (DL 848) despite SUNAT's opposition, and without taking into account its technical expertise (*Expreso*, August 23, 1996: 2; *Gestion*, September 25, 1996: 34). The massive amnesty created a serious administrative burden since 75,421 firms were registered to lower or reschedule debts, estimated in US\$750 million, on a case by case basis (*Peru Económico*, February 1997: 3). Unlike the early years of the reform, when SUNAT was more influential inside the state, none of these policy measures elaborated by MEF's policy team were adequately consulted with SUNAT experts.

The measures generated a policy debate. The business confederation, CONFIEP, considered the measures "intelligent" and approved the governmental willingness to make concessions (*Presencia*, August 1996: 15). Policy experts correctly argued that the new trend lacked coherence in terms of general macroeconomic policy orientations (Zolezzi 1996). From a SUNAT perspective, besides the policy coherence issue, other problems were important. The measures relaxed instead of enhanced tax compliance and law enforcement, and made much more difficult the administration of taxes and cases.

Limits to SUNAT's actions were also put to the test by the police and the judicial system, the most corrupt and less prestigious branches of the state apparatus. It must be noted that several attempts to reform the police have failed and the court system still undergoes a painful and incomplete reform process (Belaunde 1997). An indication of these problems is given by the fact that all legal tax fraud cases litigated by SUNAT between 1991 and 1996 were lost in the courts despite the presentation of overwhelming evidence. Where taxpayers more influential in the court system? Law enforcement against tax fraud often encountered lack of collaboration or open resistance from the police who "defended" taxpayers in cases of conflict. The backwardness of key branches of the state, an indication that SUNAT was becoming an "island of efficiency," prevented the newly found institution from obtaining increased policy success. The lower efficiency of key state

branches in charge of expenditure also collaborated in the long run to take the wind out of SUNAT's sails because taxes are paid on the basis of getting services from the state as a whole (defence and security, positive conditions for economic growth and social development). The delayed reform of the rest of the state apparatus gave ammunition to taxpayers who never showed respect to tax authorities and argued that its powers were excessive (*The Peru Report* August 1996: 11-12).

The negative factors at work in stage III showed not so much a reversion of the reform process, given the institutional strength obtained in previous stages, specially in the area of human resources, but rather a diminishing impetus of the modernizing effort and, as a consequence, less policy efficacy. In fact, in early 1996, the press speculated about Revilla's resignation. The International Monetary Fund was beginning to "monitor" SUNAT's ability to sustain tax collection (*Gestion*, February 22, 1996: 10). This was a sign that collaboration between international and national experts was not positive, another negative factor. More importantly, SUNAT's contribution to tax revenues was slowing down by mid 1996 (*Nota Tributaria* February 1997). At the same time, earnings from trade tariffs were increasing at a faster rate.

9. Conclusion

Seen from a long-term perspective, and taking into account both the positive and the negative factors, that condition state institutional development, SUNAT is clearly a remarkable case of successful reform. The tax administration has passed from being a traditional bureaucracy that degenerated into a predatory form into a modern one. This process, despite its limitations, has been accomplished in a short period of time and in a very effective way.

Changes in the state apparatus have come from the state itself and that, in turn, has helped to modify relations with civil society. This a curious pattern because the causality is often seen as the state being reformed by civil society forces, not the other way around. The SUNAT reform strongly suggests that the state enjoys in some moments enough autonomy to trigger a reform process that induces positive changes within the state and in relation to society. The task force that planned and executed the internal transformation of the tax administration became the key element of the reform process. It could succeed because the fiscal crisis was so deep, and the public administration so inefficient and corrupt, that highly trained policy elites obtained the necessary backing from the highest levels of the decision-making process. Public

opinion was also supportive of reform efforts, despite the fact that the reform itself would eventually force taxpayers to comply with the law.

The reform altered the correlation of forces within the state apparatus by transforming the tax administration into an autonomous institution, linked to the presidency, and connected to the key economic cabinet position. Despite the diminishing influence of the tax administration when the reform becomes "normalized," SUNAT still stands as a powerful, well established, respected institution, a key part of the state apparatus.

The model of change was based on the idea that, given the urgency to solve the fiscal crisis, and the need to restore state capacity, the branch in charge of tax collection had to be separated from the rest and given special power and privileges. Although this strategy was not part of an incremental, more comprehensive approach to change, it at least indicated that some branches should be reformed first. Once this is accomplished, the discussion about state reform is taken one step further, and may help to induce an overall reform of the state. Similar strategies and sequences of change will be difficult to replicate because the initial conditions were exceptionally positive. The study of the SUNAT case, in that sense, explains why rebuilding the state is such a difficult task.

The core of the policy team came from the most sophisticated and modern bureaucracy, the Central Reserve Bank. It also incorporate two other segments: international experts and old tax administrators. The combined expertise of the task force was necessary to solve the "principal agent problem" since the main reformer came from outside the tax administration. The many obstacles the team initially faced where succesfully confronted thanks to careful planning. The plan opted for a sequence of change that launched first a frontal attack against main internal obstacles to change located inside the tax administration. The plan was devised and implemented thanks to a committee system that emphasized open discussion and team work. A strong esprit de corps developed thanks to strong leadership, early success to defeat the enemies of the reform process, and social recognition, also provided enough impetus to move to higher stages of the reform process.

Internal changes in the tax administration were accomplished through the early implementation of modern administrative systems designed to upgrade the institutional capacity to design, implement, and evaluate policy. In relation to taxpayers, the

relationship between the state and civil society was redefined by elevating the risk of evasion and fraud (through innovative, selective and massive, auditing techniques), and thanks to the aid of a comprehensive, well conducted communications strategy. The policy space generated in the first stages of the process were enough to institutionalize these innovations and develop a modern human resource policy as a guarantee of continuing institutional progress. Change became feasible and seemed durable.

The continuity of the reform, and its institutionalization, remain problematic. Constant changes of Superintendents in an institution still too dependent on leadership has had negative effects. Team work has diminished, and the initial sense of esprit de corps has lost its impetus. The SUNAT case also suggests that in Peru even some of the most modern and highly trained bureaucrats have a tendency to concentrate power at the cost of weakening the team work and the institutional identity. The reform, no doubt, empowered SUNAT, but its ability to influence decisions diminished because presidential support did not last long enough. In this new situation, other powerful branches of the state apparatus successfully struggled to make the autonomy of the tax administration more and more relative. Insulation from civil society added more problems in the later stages of the reform process. The goal to extend the number of taxpayers and elevate tax compliance with efficient methods thanks to the institutional transformation, two critical conditions to sustain increased tax collection according to the overall economic performance, faced strong obstacles both within the state and in terms of relations with civil society.

Obstacles to further reform are also found in bureaucratic segmentation of the Peruvian state. This is particularly true in the case of tax administrations, so dependent on the overall efficiency of the criminal justice system. The police and the courts are still some of the most underdeveloped parts of the state apparatus. The fact that taxpayers view the state as a single entity and look at the overall performance of the public sector negatively affects tax reforms. Public opinion recognizes the modernization effort, but in the end tax compliance is based on the performance of the state as a whole. If the spending side of the state apparatus is less efficient than the tax collection agency, the goals of the reform gradually become more and more difficult to be accomplished. Increased tax pressure has forced taxpayers to react to the reform by influencing the policy making process in ways that limit the possibilities of sustaining the reform effort. As a consequence, policy efficacy in terms of tax collection has

diminished. These are consequences of the process of change that appeared in late stages and, because of the lack of experience, were initially unforeseen by the policy team.

Despite the resistance to change, and the new challenges ahead, there is no question that a fragment of the state has been reformed. The new foundations of the tax administration appear to be strong enough to face a number of challenges and avoid the pitfalls of institutional regression.

Most likely, SUNAT will remain an "island of efficiency." It is a small step if one looks at the whole state apparatus, but it is a remarkable accomplishment if one realizes the obstacles that had to be overcome in order to change one branch of the state apparatus. Bureaucratic disfunctionalities still exist in the Peruvian state but are less acute. The changes in the tax administration has helped to raise a very important question that was less visible yesterday: institutional development must include other key branches of the state apparatus.

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