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Jamaica Tax Reform: Evaluation and Lessons

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The Government of Jamaica implemented a major reform of its income tax structure in 1986. A complicated, narrow-based individual income tax, levied under a progressive statutory rate structure, was replaced by a broad-based, flat rate tax. The top marginal rate was reduced from 57.5% to 33⅓%. In 1987, the company income tax was also simplified and its rate reduced from 45% to match the new individual income tax rate. A new property tax roll was introduced in 1986 and the tax rates were rolled back to cushion the shock. To keep step with the structural reform, the organization of the Revenue Services was revamped, a comprehensive programme of revenue agent training was established, and a full computerization of the tax administration is well underway.[1]

The programme appears to have been a success. The structural reform gained general acceptance from the public, Government revenues increased (in spite of the nominal tax rate reductions), – the performance of the business sector of the economy improved, and there was a noticeable improvement in tax administration. Jamaica's comprehensive reform programme is not yet complete. A general consumption tax of the value added type has been designed to replace much of the present, complicated system of 5 separate indirect taxes, and a total overhaul of the payroll system tax has been proposed. In both cases the emphasis is on simplification, removing the tax influence of economic decisions, fairness and revenue neutrality.[2]

The purpose of this article is to describe the tax reform programme, provide a first, ex post evaluation of its success, and to suggest the lessons from the experience that could be useful to fiscal planners in other developing countries.

THE ECONOMIC AND POLICY SETTING

The Jamaica case may dispel a longstanding myth about comprehensive tax reform: the proposition that it cannot take place in a weak economic setting. Severe economic problems had to be confronted during the period of the Jamaican tax reform, and the Government could not keep its attention focused solely on restructuring its tax system and improving its administrative set-up. The following will give some idea of the calls on economic policy during this period:

- There was a serious exchange rate disequilibrium which eventually led to a major devaluation of the Jamaican dollar in November 1983.
- The bauxite industry collapsed, depriving the Government of a major foreign exchange earner. The performance of tourism, the other major foreign exchange earning sector, was spotty.
- There was a substantial Government deficit (around 8% of GDP in 1985). This is an especially important policy issue because the Government is a major employer of unskilled workers, hence expenditure retrenchment (vs. revenue increases) would be a very difficult path.
- There was a heavy debt service burden, averaging over 45% of export earnings in the mid-1980s.
- Both the inflation rate and the unemployment rate remained high during most of this period.
- The International Monetary Fund (IMF) and the World Bank brought pressure on the Government to take drastic measures to control the size of the fiscal deficit and to reform its tariff structure.
- It was reasonable during this period to suppose that a U.S. tax reform was in the offing, and that a lowered U.S. corporate tax rate would force a reduction in the Jamaican corporate tax rate.

In short, there was a great deal of pressure to find ways of raising more revenue to solve some of the Government's immediate problems and this seemed incompatible with the goal of developing a structural reform that would gain broad public support and stimulate new private investment.

But not all was negative. Prime Minister Seaga was elected in 1980 with a mandate to "free-up the economy", and there was much to free up. The foreign trade sector was charac-

1. The tax reform project was carried out jointly by the Revenue Board of the Government of Jamaica and the Metropolitan Studies Program of the Maxwell School of Syracuse University. The co-directors of the Project were Canute Miller, Chairman of the Revenue Board, and Roy Bahl, Maxwell Professor of Political Economy at Syracuse University. The research staff included Jamaica's top tax analysts and several of the most experienced public finance scholars and practitioners in the world. A set of the 37 staff papers from the project is available from the Metropolitan Studies Program, Maxwell School, Syracuse University, Syracuse, New York 13244-1090; and *The Jamaican Tax Reform* is forthcoming from Oegleschlager, Gunn and Hain of Boston.
2. Michael Manley became Prime Minister in early 1989 and one of the first steps of his administration was to label a Ministry Paper proposing adoption of a general consumption tax. Details of the proposal have not yet been worked out.

terized by quotas and licensing to restrict imports and to compensate for an overvalued Jamaican dollar. An inherited import substitution growth strategy and a very complicated tariff structure were in place, and there were substantial price controls, Government ownership of some traditionally private sector activities, and very high marginal income tax rates. The Prime Minister's economic strategy of replacing Government controls with market forces fit very well with a structural tax reform programme designed to "get the prices right". Moreover, the Seaga administration won an overwhelming majority in Parliament in a 1984 election. This enhanced the possibilities of eventually passing a tax reform bill. Another stimulus to action came from the external donors – the U.S. Government, the World Bank and the IMF – all of whom were enthusiastic about Jamaica's plans for tax reform. Finally, the Jamaican tax system had become so onerous, so obviously unfair and so out of control that there was substantial public sentiment for a major overhaul. In many ways, then, the time was right for tax reform.

Tax policy strategy

At the outset of the Project, assessment of Jamaica's tax problems pointed to 3 issues. First, taxes were too high. Taxes were too high by comparison with other countries at similar levels of income and foreign trade. More important, however, is that the Jamaican system taxed such a narrow base that the nominal average and marginal rates had to be very high to generate an adequate revenue yield. For example, a value added tax, equal in yield to the present indirect tax system and using the same exemptions as existed in 1983, would have required a rate of about 20%; the top marginal personal income tax rate was 57.5% (not including payroll taxes) and was reached at the relatively low income level of J$ 14,000.[3]

The second basic problem was the tax structure. It was complicated and therefore difficult and costly to administer and there were important disincentives inherent in the rate and base structures. Interest was tax-free but dividends were taxed twice, there was a high income tax rate on formal sector (PAYE) labour income but the self-employed went virtually untaxed, the high marginal tax rates produced a substantial incentive for evasion and avoidance, many types of imports were exempt from the indirect tax system, and so on. The system was also characterized by a poor enforcement which compounded the inequities. The problem was simply that the Jamaican tax structure had evolved over a period of time – as much because of year-to-year pressures to solve budget deficits as for any other reason. By 1983 the issue was clear: the Government had gone as far as it could with piecemeal tax reform and the time was right for a comprehensive overhaul of the tax structure.

Third, the administration of the tax system was weak. There were too few trained tax administrators, salaries were not competitive with the private sector and there was limited opportunity for advancement. These administrative problems were heightened by the complicated system which was difficult to administer in any case, and by outmoded procedures. For example, there was no manual for income tax administration, nor were there procedures in place to assess the self-employed or to use third party information to detect non-reporting or under-reporting. Audit activities were limited and not productive, and the administration of the income and payroll taxes was not integrated. Finally, the administrative system was not fully computerized and there was general disarray in the record-keeping.

In the face of this assessment of problems, the Project took the view that the highest priorities were (a) simplification of the system, and (b) making the tax structure more neutral with respect to consumer and investor choices. The policy direction of these objectives is clear: establish broader based, flatter rate taxes that are more easily administered. The basic hypothesis is that the price effects introduced by non-neutralities in the Jamaican tax system do matter, i.e. the tax system has contributed to a reduced work effort, increased capital and labour mobility from the formal to the self-employed sector, thin capitalization of companies, capital flight, low investment relative to consumption, high retained earnings relative to distributions and a larger underground economy.

The Project did not take the view that the correct tax reform strategy was to develop a system that would lead and "fine tune" economic policy. The general position taken was that the market and not tax treatment should dictate business and individual economic decisions, and that, in any case, the present administrative system could not carry the implementation of such a programme. Experience with the existing system, which is in more of an interventionist tradition, was that the goals of the present, complicated structure were not being achieved anyway: progressive rate structures were not generating a progressive distribution of tax burdens, complicated provisions for payroll taxes of the self-employed could not induce them to make payments, tax incentives for overtime were being abused and not leading to increased overtime work, a system of non-taxable perquisites had become a major loophole rather than a tax relief and was beyond the control of the income tax administration, etc.

This assessment of problems and definition of objectives of the Project led to a 3-part programme for the tax reform: policy analysis to restructure the system, improved administrative procedures and the establishment of a training programme. The basic tenet of the Project was that the reform should be comprehensive and that the administrative improvements should be designed to be compatible with the policy changes. To try to improve the administration of a system so deficient as that in Jamaica clearly would have been counterproductive.

Individual income tax

The individual income tax base, in theory, included all sources of income except bank deposit interest. In practice, there was no tax on capital gains and most self-employed income was outside the tax net. There were 2 rate structures – depending on whether income was above or below J$ 7,000. The top marginal rate was 57.5%. When payroll taxes are taken into account, the marginal tax rate on a Jamaican income (J$ 14,000) was well in excess of 60%. There was no standard deduction but taxpayers could qualify for 16 separate tax credits. These credits had been added to the tax system over a period of years for purposes that ranged from personal allowances to stimulation of savings and home ownership, and even employment of helpers in the home. Because the credits were not indexed to inflation, their value had substantially eroded during the early 1980s. The income tax administration did relatively little monitoring of the credit system.

The base of the tax was further eroded by the practice of permitting employers to grant non-taxable perquisites ("al-

3. The average exchange rate when the income tax reform was constructed in final form in 1985 was US$1 = J$ 5.56.

lowances") to employees. These perquisites were a matter of negotiation between employer and employee (including Government ministries) and it was not required that they be reported to the Income Tax Commissioner. There was a great deal of speculation about the magnitude of allowances – some prominent Jamaican analysts speculated that the allowance-taxable wage ratio averaged as much as 40%.

The analysis of reform options required first estimating the number of taxpayers, taxable incomes, non-taxable perquisites and tax credits – all by income class. This was done by drawing a large random sample of Jamaican taxpayers and manually recording data on taxable income, tax credits, tax liability, etc. from the files on each employer and each individual. The Prime Minister organized a special survey of employers to estimate the value of non-taxable allowances by income bracket. This was supplemented with a sample survey of a large number of self-employed individuals to determine the extent of evasion by non-reporting. The results of this analysis indicated that about half of potential individual income tax liability was not covered in the tax net. Moreover, higher income Jamaicans – many outside the PAYE system – tended to avoid or evade a substantially higher percentage of their tax liability than did lower income families. The progressivity of the statutory rate structure was all but negated by evasion and avoidance.

Simulation of alternative rate and base structures, with a revenue neutral target in mind and with simplification and neutrality as primary objectives, led to the following reform programme:

- Replace the present graduated rate structure with a flat rate of 33⅓%.
- Replace the 16 tax credits with a standard deduction of J$ 8,580 per year.
- With a few exceptions, bring all non-taxable allowances into the base.
- Include bank deposit interest (above a low ceiling) in the income tax base.

The Government enacted this programme after a Tax Reform Committee of private sector citizens spent several months scrutinizing and amending the proposals. The Committee, comprised of union, business and public interest group representatives, reached consensus that the flat tax seemed more fair than the present system and recommended its adoption to the Prime Minister. The income tax reform became effective at the beginning of 1986 and was almost totally operative by the end of the first quarter.

Company income tax

Prior to the reform, companies paid a basic rate of 35% plus an "additional tax" of 10%, but the additional rate could be offset against withholding tax on dividends. To complicate matters further, there was separate treatment for agricultural companies, incentive firms and financial institutions.

This system led to 3 basic problems. First, the tax was complicated, not easily administered, and unfair to certain types of firms. Second, it discriminated in favour of debt and against equity finance, in favour of retaining rather than distributing earnings, and against risk taking. The "optimal" dividend distribution rate for a firm was about 27% of profits – above this amount "additional" profit tax liability would be due. Moreover, in the eyes of investors, dividends were taxed twice whereas interest received from savings accounts was not taxed at all. Third, the reduction in the top individual income tax rate to 33⅓% and the reduction in the U.S. corporate rate brought new pressures to lower the company tax rate.

The Government enacted a comprehensive reform of the company tax in 1987. The tax rate was reduced to 33⅓% and the "additional tax" was eliminated. This removed the disincentive to larger dividend distributions, and though the Government did not eliminate the preferential treatment of retained earnings, it did bring interest income into the tax base thereby removing another disincentive to equity finance. Full loss carry-forward was introduced, removing some of the bias against risk-taking, and branch and subsidiary companies were given an equal tax treatment.

The Project's proposal to exempt dividends from personal tax liability was rejected. The Government instead decided on a separate entity approach whereby company profits and dividends each would be taxed at 33⅓%, thus passing on the opportunity to fully (and simply) integrate the income tax. Why would such an opportunity be passed? One reason given was that the Government was in a crucial stage of its negotiations with the IMF and under pressure to minimize the revenue cost of the reform package. Another explanation is political, i.e. the Government's sensitivity to the growing public perception that it had become the party of the "big man". The Government was still feeling the criticism over the taxation of interest income that had been introduced, along with steep cuts in the marginal personal income tax rates the year before. There also was the problem of explaining to the public the difficult concept of integration.

Property tax

Relative to the amount of revenue it raises, the property tax is the most politically sensitive tax in the Jamaican system. In fact, the problems with the property tax in Jamaica are not primarily structural. The structure of the tax itself is one that, properly implemented, could serve as a model for other countries. For a number of years, however, the Government was unwilling to operate the tax according to the law with the result that it became negligible in revenue yield and unfair in the distribution of burden it imposed.

The base of the property tax is the unimproved market value of land, i.e. the value of raw land, or the value of a parcel of developed (improved) land as it would be if there were no structures on the site. The valuation roll is to be updated every 3 to 5 years, though in practice it is much less frequent. There are 3 important classes of preferential rate treatment or exemption: agricultural properties, hotel properties and low value properties. In effect, Jamaica's is a classified property tax with lower rate schedules applying to agricultural and hotel properties.

About 60% of Jamaica's 550,000 parcels have land values less than J$ 2,000 (about U.S.$ 500 in 1984), and are subject to a nominal property tax charge of J$ 5 per year. The remaining properties are taxed according to a rate structure that is progressive in terms of land value, rising to 4.5% on a site value of J$ 50,000.

The revenue yield from the tax has fallen over the past decade from a little over 5% of total revenues to about 2%. This decline occurred principally because the schedule of assessed values was not changed between 1974 and 1986. The property tax is a central government levy in Jamaica, and local governments do not share explicitly in the revenue yield.

There are 2 problems with the property tax as it has been practiced in Jamaica. The first grows out of the failure of the Government to bring in a new valuation roll for 12 years, and the second has to do with inadequacies in the day-to-day administration of the tax. More debatable as "problems" are whether the progressive rate structure discourages compliance, and whether the improved value of property would be a more appropriate base.

Before the 1986 reform, the taxed base was the 1974 value of sites. Because this base was fixed for over a decade, the yield from the property tax fell to its negligible present position in the revenue structure. This lack of buoyancy created a number of problems:

- The low revenue yield puts that much more pressure on the individual income tax and indirect taxes to carry the revenue load.
- Landowners are undertaxed relative to labour and owners of capital. This discriminatory practice fits neither the economic nor the social policy of the Government.
- Landowners were not taxed according to the present values of their properties, but according to the 1974 values. Because the pattern of land values has changed dramatically during this period, the resulting distribution of tax burden is unfair.

Finally, there are problems with the administration of the property tax. Consider the following:

- The collection rate for the property tax is only about 60%.
- The collection cost is equivalent to about 12% of revenue collected.
- There are no reliable records on derated properties, i.e. no list of the total number that receive preferential treatment, the nature of the preference, etc.
- About one-third of the sites on the roll do not have any coding as to use.
- Total property tax arrears are equivalent to over 2 years revenue yield.

The Project and the Tax Reform Committee considered a number of options for reforming the property tax, and recommended the following:

1. The land value base should be maintained.
2. The revenue from the property tax should be 3 times the present level. This would restore the property tax to the revenue level it would have achieved if its base had been kept up to date.
3. The 1984 valuation roll should be adopted, and a flat rate should be applied to all land with value in excess of J$ 6,000. This would keep about 60% of properties off the roll. To avoid tax shock, it is advisable to phase this new system in gradually, by even increments over a 3-year period.
4. Agricultural and hotel derating should be eliminated or substantially cut back.
5. The administrative system should be completely overhauled, with particular emphasis on (a) improving collection procedures and record-keeping, (b) developing a sales data bank that would permit assessment-sales ratio studies, (c) indexing land values to update the valuation roll between general revaluations, and (d) monitoring relief and derating in a more systematic way.

The Tax Reform Committee generally accepted these recommendations in proposing a tripling of the revenues to be accompanied by an equal amount reduction in the income tax, the bringing in of the 1984 roll, the retention of the land value basis, and a 3-year period to phase in the reform. The Committee was silent on the issue of derating and held to the present progressive rate structure.

The Government followed the recommendations to bring in the new land value base and to roll back the tax rates so as to minimize the amount of tax shock. The derating programme for agricultural and hotel properties was continued. On the subject of the next revaluation, the Government committed to work on an indexing system, but little progress has yet been made. The reform programme, enacted in 1986, has been a mixed success.

Revenue growth nearly reached target amounts after 2 years, thanks in part to significant administrative efforts. However, the Government responded by freezing the nominal rates at the 1986 level which probably guarantees that the property tax will remain at approximately 2% of revenues.

As in all countries, property taxation draws criticism from the public that it is far out of proportion to the amount of tax burden involved. This was also the case in Jamaica. One possible reason for the opposition is that it is a national tax and therefore the financing link to specific local services cannot be easily seen. Another is that the Government was unsuccessful in convincing voters that one price of the popular income tax rate reductions was an increase in the property tax.

A successful income tax reform?

No effort has yet been mounted to systematically monitor the impact of the flat tax reform. The major problem, of course, would be to try to separate the effects of tax changes from the effects of everything else that is affecting the Jamaican economy. Still, from the macro evidence, there is some indication of success. Perhaps the best indicator is the lack of any continuing public discontent with the income tax reform. The press was not critical, the political opposition did not raise substantial objections – even during the recent national elections, labour seems to be pleased with the relatively high standard deduction and with the fairness of a flat rate, and the business community clearly has benefited from the lower company tax rate. To be sure, there was initial resentment to taxing interest income – this led to exemption from small deposits – and there was the expected grousing from special interests about the loss of tax preferences. The important point, however, is that the public adjusted to the initial shock of the change and though taxes are never as low or even as fair as citizens would like, the new system would appear to be much more palatable than the previous one.

Did the income tax reforms stimulate the economy after 1986? Something did. Corporate profits rose – through August 1987, the 16 largest listed companies reported post-tax profits 84% higher than the same period in the previous year. The Jamaican stock exchange had record growth during 1986 and 1987. The market index went from 941.5 at the end of 1985 to 1499.8 at the end of 1987 and stood at 1757.7 in 1987. Of course, the tax reform is only one of the number of positive factors that affected the Jamaican economy. The interest rate dropped from 93% at the beginning of 1986 to 16.7% in 1987. The real growth in exports was up by 10.3% in 1986 over the 1980-1985 period average and real GNP increased by 2.1% in 1986. The rate of inflation declined from 25.7% for all of 1985 to 15.1% for 1986, and was running at 7.1% for the first 5 months of 1987. On the basis of available evidence, no one could argue the extent to which these changes are due to the tax reform, but many would be prepared to argue that so favourable a performance of the Jamaican economy could not have taken place under the old regime.[4]

The revenue neutrality target of the reform was attained, perhaps even surpassed. Comparing the same quarter in the first year of the reform (1986) with 1985, PAYE collections were up 9.7%, and in 1987, the same comparison shows a 17.9% increase over 1986. Total company and personal income taxes in the second quarter of 1987 were about 18% above second quarter 1986 collections – a substantial increase in real terms. Some part of this increase no doubt is due to administration. The simpler income tax system has made it possible for the income tax department to concentrate more on enforcement of the system and there is evidence of a more effective audit and examination activity. More vigorous audit activities have led to a tripling of additional taxes and penalties in 1987 over 1986.

There is also a question of the fairness of the new reform. The Project has estimated that the combination of the lower, flat rate, the J$ 8,580 standard deduction and broadened base did not worsen the regressivity of the system and, indeed, that improved administration holds the promise of making the new system more progressive than the old.

The structural reform stimulated administrative improvements. The revenue services have been reorganized to better integrate assessment and collections; an extensive training programme for revenue agents has commenced; a number of courses for income tax assessments and collections have been successfully completed; and computerization of the revenue services is now well under way.

The reform is not without problems – no reform ever is. Perhaps the major problem is that the door was left open for abuse of certain perquisites to avoid income tax payment – the housing allowance, the travel allowance and uniform allowances. There already appear to be some misuses of these provisions for non-taxable income and if they continue to grow they could compromise the fairness of the new structure and bring pressure for a rate increase. Another important problem was that provision was not made in the original reform package to index the standard deduction. The result was "bracket creep" in the sense that real economic growth on the island pushed many taxpayers from the zero to the 33⅓% bracket. However, just prior to the 1989 elections, the non-taxable threshold was increased from J$ 8,580 to J$ 10,400. This approximately "indexed" the individual income tax for the 1986-1988 period and dropped 32,000 potential 1989 taxpayers from the roll, at a revenue cost of J$ 106 million or about 20% of projected revenues.

The Jamaican tax reform is in its early stages and is fragile. Indications are, however, that its early performance has more than lived up to expectations. The objectives of creating a simpler system that is more easily administered and has fewer price distortions appears to have been achieved. This has been done without compromising revenue yield and, using the Project's estimates, without having unfavourable effects on the distribution of tax burdens.

THE UNFINISHED AGENDA

A sweeping reform of the present system of indirect taxation has been designed but not yet implemented. Presently, there are 5 separate indirect taxes: (a) consumption duty, the most important revenue component of the system, is levied on the value of imported and domestically produced goods and is collected at the import and the manufacturing stage; (b) retail sales tax and excise duties which are insignificant in terms of revenues raised; (c) customs duty which is a relatively small revenue source by international standards; and (d) stamp duty on inward customs warrants which has become a major fiscal instrument. This system is overly complex, distorts economic choices, is income inelastic and badly administered.

The Project proposed that a general consumption tax replace the present system. The base of the tax will include importers, manufacturers and large distributors, with the value added feature of allowing a credit for taxes paid on inputs. Exporters would be zero-rated (no tax would be due on value added *and* all taxes paid on inputs would be refunded) and the major consumption items for low income families would be excluded from tax, but otherwise there will be few exemptions. This should lower the costs of administration and compliance, make the system less horizontally inequitable, and eliminate some unintended effects on methods of doing business. For reasons of administration, much of the service sector will be outside the base, as will small, handicraft-type manufacturers, smaller distributors and all but the largest retailers. It is proposed that the present system of taxing cigarettes, petroleum products and spirits remain unchanged for the time being in order to protect revenue and minimize the amount of disruption associated with the reform.

The other unfinished part of the reform is the payroll taxes. There are 2 major problems that the Government needs to address with structural reform. The first is the narrow base on which the payroll taxes are levied and consequently the high nominal rates of tax. The second problem is that administration of the 5 different payroll taxes is fragmented and there is little coordination among the programmes. The Project recommended that payroll tax reform should concentrate on simplification of the system, a broadening of the tax base and a lowering of rates, and a general overhaul of the administration of these 5 taxes.

At the time of the income tax reform in 1986, the rate of payroll tax contribution was frozen, and at the time of this writing, no permanent improvements have been made.

LESSONS FOR TAX REFORM

The Jamaican tax Project was a rare opportunity for comprehensive tax reform in a developing country. The mandate at the outset called for a restructuring of the tax system to fit a new economic programme of a newly-elected administration, and the Project was given substantial latitude in defining the coverage of the work. The experience in Jamaica provides a real-world setting in which to rethink some of the principles of tax reform and tax policy analysis in developing countries. In some cases, old lessons were relearned. But the Jamaica experience also suggested some areas where the conventional wisdom ought to be challenged.

1. A comprehensive reform of the tax structure can be carried out when the economy is performing poorly.

There is a sense that something must be done and tax policy is one area where the Government can take aggressive action. In such times, it is easier to focus the attention of policymakers on the structural problems within the entire

4. Prime Minister Edward Seaga, relating the tax project to the improved performance of the economy, said: "This year we are experiencing the highest levels of growth that the country has enjoyed since the early 1970s", *Daily Gleaner*, 10 October 1987.

tax system and to think through the ways in which the tax system may be retarding economic growth.

Jamaica's tax reform project began when the economy was in dire straits: real GNP was declining, a devaluation was quite clearly in the immediate offing, the external debt burden was heavy and the country was under pressure from the IMF and World Bank to reduce its budget deficit and limit domestic borrowing, and the unemployment and inflation rates were at high levels. Things were bad enough that the Administration and the general public were in agreement that nothing short of a complete overhaul of the tax system would do.

2. Comprehensive reform can take place only if the system is shocked

The conventional theory suggests an incremental approach to tax reform, i.e. it argues that if the existing system is shocked too much, it will compromise the success of the proposed reform. While there is wisdom in this argument, the Jamaica experience suggests not only that the tax system can be shocked under the right circumstances, but that comprehensive reform can only take place if the system is shocked. There are 2 principal supporting arguments. The first is that the reform must bring enough of a change for the taxpayer to see a package of gains and losses. The second is that the response of savings, investment, work effort and compliance to a tax rate change may be quite small, and therefore it will take big structural changes to have any significant impact.

Every tax reform cannot be comprehensive, and all students of public finance in developing countries know that tax shock can be a disaster. The Jamaica case, however, can highlight the conditions under which big changes can work. First, the Government and the public must have lost confidence in the present system. Certainly Jamaica had reached the point where patchwork reform was no longer good enough. Second, the Government and the public need time to absorb the shock. There was a full 6-month debate of the proposals in the Jamaican press and by the time of enactment, the shock effect had pretty much dissipated. Third, the possibility of revenue shock – large first year losses that might result from transition problems or from the appearance of unexpected loopholes – were guarded against in the Jamaica reform. Finally, the administrative system must be able to absorb the change.

3. Vertical equity cannot be the driving force behind a comprehensive tax reform programme in a developing country

In part, this is because developing countries cannot successfully implement "progressive" features of tax systems and, in part, it is because the costs of vertical equity are very high. The creation of a progressive distribution of tax burdens may not even be a primary consideration in formulating a tax structure revision because of the inherent tradeoff between vertical equity on the one hand and the goals of efficiency and simplification on the other.

What is the place of equity in comprehensive tax reform? The first goal ought to be to protect the lowest income families in the society. The Jamaican Project carried out a family budget survey to identify the market basket of low income families and used these results in the recommendations for indirect tax reform, to work toward a system that was roughly proportional in its distribution of effective rates. Fine tuning the distribution of tax burdens to achieve some particular pattern of progression was not considered.

More important is the issue of horizontal equity – what the Jamaicans seem to have equated with fairness in taxation. The system was riddled with inequities: private sector workers received more income in non-taxable perquisites than public sector workers, self-employed workers paid lower taxes than those in the PAYE sector, those in certain industries had access to the preferential "overtime" tax rate while others did not, only some types of businesses could engage in arbitrage to avoid income taxes, etc. Such unequal treatment had undermined confidence in the tax system. The primary goal of the Jamaican study was to find a way to eliminate these horizontal inequities and the distortions in economic choices which they promoted.

4. Empirical estimates of the impact of proposed tax reforms lift the debate to a much higher level than otherwise would be the case

The quality of the underlying data may not be without problems, but they give a basis for removing some of the guesswork in evaluating the options. A major problem in defeating special interest group opposition to reform in almost every country is the mythology surrounding the implications of changing each element of the system.

In Jamaica, the individual income tax reform was particularly influenced by the data analysis. In fact, it is very doubtful that so sweeping a reform as this could have occurred in the absence of a rigorous statistical study. About 200 combinations of rate and base were eventually run through the simulation model before a final structure was chosen.

The empirical work was useful in demonstrating features of the tax system that were either not known or not obvious. The following are good examples: (a) several of the 16 income tax credits were not being used extensively, hence their abolition would not imply the revenue loss or the sensitive political issue that was feared; (b) the present graduated rate structure was not progressive in its distribution of effective tax burdens, and (c) the income tax regime which taxes dividend income at both the company and personal levels probably has less effect on dividend payout rates than does the preferential treatment of retained earnings.

5. Get the policy right and *then* deal with the administrative problems

The consumers and sponsors of a reform often cannot see beneath a plethora of administrative problems to the real issue, which may well be a badly structured tax.

There are 3 good reasons for giving policy reform priority over administrative reform. First, administrative improvements can often generate a quick revenue impact. Because this may satisfy some of the urgency about "reforming" the tax system, the Government may lose its enthusiasm about rethinking its tax policy. Second, the true underlying problem may be with the tax structure. It may be so complicated as to be beyond the capacity of the Government to properly administer, or it may be so unfair that payment of taxes will be resisted no matter how much the administration improves. Third, if the reform goes no further than administration, the Government will not go through the exercise of questioning whether the tax system is affecting the economy in ways that reinforce Government policy objectives.

The Jamaica case offers some good illustrations of why tax policy considerations should lead such work. The individual income tax was hopelessly complicated, with 3 rate schedules, 16 tax credits, and a system under which employers could choose to grant non-taxable perquisites to their employees. It would have been virtually impossible to improve the administration of such a tax and resources spent in that direction would likely have been wasted.

None of this is to say that poor tax administration is not at the heart of the fiscal problems of most developing countries. Indeed, policy reform without administrative reform can bring little gain. The Jamaica Project included a substantial effort in the direction of establishing a training centre, improving assessment procedures and computerizing the record-keeping function.

6. The results of a tax reform should be carefully monitored in the first years after implementation

While it is essential that the reform study generate the best possible forecast of revenue yield, tax burden impacts and economic effects, it is also essential that the tax planner know the actual outcome and be ready to adjust the new system as necessary. It is especially important that the monitoring begin immediately after the reform is implemented and before new avenues of avoidance become entrenched. The more dramatic the structural reform and administrative "shock," the more likely are such loopholes to appear and the harder they are to detect.

This is an important problem with the Jamaica reform. The income tax reform was meant to result in a significant adjustment in the compensation package for PAYE employees – away from allowances and toward wages and salaries. However, some loopholes were left open and these would dampen the propensity to convert allowances to wages. It is clear that there have been some abuses, but in the absence of monitoring it is not clear how much. Consequently, the guidelines for further tightening legislation or providing tougher enforcement regulations are not clear.

Another reason for monitoring is to determine whether the reforms have met revenue targets and consequently whether some base or rate structure revision is necessary. It is not enough to simply rely on the ex ante projections of the revenue impact of the reform. After the Jamaica reform, the revenue yield turned out to be much greater than had been expected because the economy grew much faster than had been assumed in the forecast. This resulted in revenues well above the first year targets, and an increase in the average income tax burden. Armed with accurate revenue projections, the Government would have been in a position to at least discuss a second round of rate reductions.

7. It is better to do a comprehensive fiscal reform – which also includes consideration of the expenditure side of the budget – than a comprehensive tax reform

To be sure, this is a more difficult job, requires more resources and time, and probably raises many more controversial issues, but it allows the Government to get a better picture of the overall implications of the tax reform under consideration.

Fiscal reform is also more desirable because it allows a more comprehensive study of the options for getting the prices "right", balancing the budget, affecting the distribution of income through the budget process, evaluating least cost methods of achieving certain objectives, etc. The Jamaica reform was more far-reaching than most tax studies in that it considered the financing of public enterprises, the benefits of tax incentive legislation and the effectiveness of the Government's food stamp programme. Still, the work came up far short of considering even some of the most relevant expenditure side issues; for example, the actuarial position of the payroll tax contribution programmes, and the possibilities for user charge financing. The Project did a reasonable job of estimating who pays for the Jamaican public sector but it did not go very far in considering who benefits.

8. Tax policies should be designed to mesh with the economic policies already in place

Perhaps the most difficult part of designing a comprehensive tax reform is to match the tax policy design with the set of economic policies that is already in place. It is easy to recite the maxims of a "good tax" and to come to the proper conclusion that it should be neutral in its effects on economic choices. In the case of Jamaica, this matched the stated goal of the Government to rely more heavily on market forces to guide economic growth. However, there is almost always another set of policies in place that raise questions about whether neutrality is an appropriate objective of the tax reform.

Jamaica's trade and industrial policies are highly targeted on specific industries, export promotion and the conservation of scarce foreign exchange. Moreover, the Government's policy was pointed to holding a fixed exchange rate in terms of the U.S. dollar. If the tax reform moved in the direction of removing some of the existing distortions in the system, would the Government respond by strengthening its targeted programmes to restore the special treatments that the tax system had taken away?

9. Successful comprehensive reform requires that special attention be paid to implementation of the reform measures

The Jamaica reform suggests 5 rules about how to get to successful implementation of a tax reform. First, the Government must see the project as primarily its own and not that of a donor or even that of a technical assistance research team. The personal and close involvement of the Prime Minister set the tone for the Jamaica work, and the Chairman of the Revenue Board was an active participant in the research and a leading contributor to the thinking. A very important, and beneficial development in the Jamaica work, was the Prime Minister's appointment of an independent Tax Reform Committee. The Committee was comprised of 12 leading citizens and included representatives of most of the major public interest groups. The Project worked directly as staff to the Committee in their review of the tax reform proposals and in the formulation of the alternatives which they put forth to the Government.

Second, the technical assistance team should have the right mix of skills and experience, and above all, should have expert credentials. Nothing short of well-known tax policy experts with extensive policy experience would have satisfied the Jamaicans. The Government was understandably uneasy about the risks and uncertainties associated with the reform and, moreover, some aspects of the reform were very complicated and others raised important issues of administration that appeared to be stumbling blocks. It was essential to have senior staff who could draw easily and confidently on knowledge of tax systems and of successes and failures elsewhere.

Third, tax reform should not be hurried. It takes time to get the technical proposals properly in place, and the public debate needs time. The design work on the income tax took more than one year, and on the CGT, took longer. The Jamaican press and public interest groups were all involved in the debate, at a surprisingly technical level, for a full 6 months before the income tax reform was implemented. By the time the law was enacted, a very major change in the system was not seen by the public as a tax "shock".

Fourth, there is an important issue of timing. The income tax reform has been enacted but the Government has not yet moved to introduce the GCT or restructure the payroll taxes. The lesson here is that a Government is not willing to be identified indefinitely with tax reform, even good tax reform.

Comprehensive reform tends to be associated with a particular administration and there is need to get on with it while the power is in place and while there is still enthusiasm for the reform programme. Even the best of tax programmes carries unfavourable connotations for most citizens and politicians, and the zeal for even so noble a goal as "getting the prices right" wanes as time goes by and election years draw near.

Fifth, implementation requires a great deal of in-country attention. The Project had 2 income tax administration experts and a customs expert resident in country to work out administrative procedures and to assist in training, and a sales tax administration expert to do the same for the GCT. There were also a general economic advisor for one year, junior American and Jamaican staff, and a functioning project office in the Revenue Board in Kingston. This made the Project less remote to the Jamaicans and enabled daily liaison.

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Books

The publications listed in this bibliography have recently been acquired by the Bureau's library which will gladly supply further information upon request (please quote the reference numbers). They should, however, be ordered through a bookseller or direct from the publisher indicated, and not through the Bureau.

To facilitate ordering, a list of addresses of the main publishing houses is included on pages 49-52 of the January 1990 issue. Addresses of publishers which do not appear in this list are indicated in the item concerned.

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