

## Perspective in Tax Design and Tax Reform

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### INTRODUCTION

The practice of tax design and tax reform has been with us for many centuries in one form or the other. But they have not been properly conceptualised by experts in public finance. Even the recent attempts to suggest normative economic criteria for 'optimal' taxation<sup>1</sup> have ignored the close logical as well as practical relation between tax design and tax reform. In these recent attempts while the economists have gone on theorising on optimal tax design,<sup>2</sup> tax lawyers have concentrated their efforts mostly on tax reform. But any useful exercise on tax reform should take into account both the theory and practice of tax design. Since both tax design and tax reform are concerned with practical aspect of the operation of the tax structure, they should be based on both theoretical foundations as well as on practical aspects involved in their actual operation. Further, their theoretical foundations are rooted not merely in economic theory but also in jurisprudence. Furthermore, their practical operations are determined by the legal acumen, administrative capabilities and other institutional environment like political and social institutions and their bearing on the attitude towards payment of tax. Thus the study of tax design and tax reform, in order to be more useful in practical application, should encompass economic, legal and administrative aspects. Such a comprehensive approach to tax design and tax reform needs to be emphasised in view of the disconnected way in which they have been studied and also because of the isolated attempts of economists and tax lawyers to formulate general guidelines for tax designing and tax reform.

In this paper I propose to present mainly the economic aspect of tax design and tax reform for two reasons. First, though the theory of public finance has developed to a desirable level of sophistication, it has not been properly linked with the practice of tax design and tax reform. Second, in order to cover legal and administrative aspects also, one has to be proficient in all these disciplines which is beyond the reach of the present author. Therefore, a modest beginning is made here to show the economic theoretical foundations of tax design and tax reform and to highlight the practical considerations which need to be taken into account in order to make the tax structure to operate in the desired way. Thus, even in the narrow field of economic aspect, an attempt is made to show the logical connection, if any, between theoretical foundations and their practical applications in both designing a tax or a tax structure and formulating tax reform measures.

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## TAX DESIGN AND TAX REFORM

Tax design is concerned with designing a tax/tax structure de novo, whereas tax reform is concerned with adjusting an already existing tax/tax structure to changed circumstances. Tax design includes (i) imposition of an altogether new tax, (ii) replacing an already existing tax by a new tax, (iii) abolishing an already existing tax and (iv) introducing new tax base, new rate structure etc. Tax reform includes introducing changes in the existing tax base, tax rates, exemptions, concessions and the administrative procedures.

For purpose of clear understanding we may classify tax design and tax reform into three categories based on the agency in charge of designing the tax and suggesting tax reforms. They are (1) tax designing and tax reform by the legislature, (2) tax designing and tax reform by the executive and (3) tax designing and tax reform recommended by the Expert Committee.

When a new tax is suggested and its actual design is shaped in the legislative process based on public opinion, and/or the pressure of 'self-interest groups', it becomes a tax design by the legislature. This includes the stages of legislators' initiating public discussion, pressurising the government to introduce the necessary legislation based on such opinions, changes proposed in the Committees of the legislature, and the changes proposed in the legislature while passing the legislation.

Tax design and tax reform by the executive refers to the initiative taken by the bureaucracy to persuade the government to accept its suggested tax design and reform based on its own thinking, review, experience etc., or influenced by the experiences of other countries or by independent expert opinion.

Finally, tax design and reform suggested by an independent Expert Committee appointed by the government is the most important and desirable type of tax designing and tax reform. This is because, the required necessary information and technical know-how, which go with an Expert Committee, may be absent in the first two types of tax designing and reform. Further, the required objectivity both in identifying the desirable characteristics of tax design and tax reform, evaluating dispassionately the existing tax structure, and formulating more objective measures can be expected from an independent expert Committee. It is plausible that even this category of tax designing and tax reform may be initiated by the legislators' demand and/or bureaucracy's realisation of the need for seeking the advice of an independent Experts Committee. Therefore, in the ultimate analysis all these three types of processes of tax design and tax reform are interrelated.

Thus tax design refers to tax engineering aspect and tax reform refers to periodical repairs to the structure after it is designed and installed. Tax design is the science and art of creating the structure of a tax and/or the tax structure as a whole. This involves choice of taxes, choice of tax bases, choice of tax rates, choice of other ele-

ments of tax structure such as exemptions, to make a tax or a tax structure satisfy certain normative economic criteria which are considered necessary to achieve the objectives of the government. Tax design is concerned with suggesting normative criteria for formulating the tax legislation. These criteria embody economic, legal and administrative norms. In order to design a tax-tax structure the tax designers would find out the empirical basis of these norms. It is also necessary to understand the existing economic interconnections.

However, it is quite possible that the empirical results may not support the abstract theoretical economic criteria suggested to guide tax design and tax reform. In that case economic criteria will have to be modified in the light of empirical results, assuming that such empirical results are reliable. If reliable empirical results are difficult to obtain in actual practice, normative economic criteria remain abstract relations without appropriate empirical methods and/or data to support them. Therefore, circumstantial evidence, intuition and practical wisdom should be combined to accept or reject the normative economic criteria.

Once the tax/tax structure is designed on the basis of such criteria, it goes into operation as soon as it is implemented. From its practical operation, besides the tax paying public, the government and the tax administrators learn about the merits and demerits of the tax structure, either on the basis of practical experiences or from empirical tests or both. The merits and demerits of a tax/tax structure are examined and identified with reference to the major objectives which the tax/tax structure is supposed to achieve. These objectives are invariably the economic policy objectives or plan objectives of the government which are attempted to be achieved through the budget. While considering the rationality of tax design and tax reform, we examine them with reference to certain economic policy objectives of the government. These objective functions are with reference to the tax collecting social agent which is the government. Generally accepted objectives include promoting higher growth rate of national output, reducing wide inequalities of income and wealth, maintaining stability of the growth of output, prices, and balance of payments which are supporting objectives for the first two objectives. Though these are the broad objectives of democratic society in normal times other objectives like winning war, rehabilitation of the people and the economy after war or after other calamity may emerge. However, such specification of objective functions is also necessary from the point of view of the tax payer. But in the ultimate analysis, we proceed from individual welfare functions to social welfare functions. Social welfare functions are decided by the government keeping in view the preferences of the majority of the voters who are also the taxpayers. Hence it may be assumed that the spectrum of individual objective welfare functions ultimately get reflected in the national policy objectives of the government. The tax design is created to serve these objectives.

If in course of operation, that tax/tax structure is not found to be surviving these objectives, then introducing required corrections into the tax design becomes necessary. This is the core of tax reform. It starts with a thorough examination of the operation of tax/tax struc-

ture in relation to the economic policy objectives, finding out empirical facts about its defects, identifying the causes for defective operation, examining alternative measures to set right the defects and recommending specific tax reform measures in order to restore its effectiveness. It would be desirable to enumerate the relative merits and demerits of alternative tax reform measures and leave the choice to the policy makers.

Tax reform may also be necessitated by the (1) changed socio-economic and political situations and (2) changed objectives. Changes in the economic structure may call for certain changes in the tax structure to achieve the same objectives. Change in the government may require change in the priority of different objectives and/or addition of new objective and hence, necessary required changes in tax structure become inevitable. Thus tax design refers to creation of a tax structure and tax reform refers to changes in the tax structure to adapt it to the changed situations and objectives.

It has been rightly observed by Martin Feldstein that "Although there have been substantial contributions to both the theory and the policy analysis of optimal taxation, all of these studies have dealt with tax design rather than tax reform. Discussions of optimal taxation implicitly assume that the tax laws are being written de novo on 'a clean sheet of paper'. Such tax design is a guide for tax policy in the Garden of Eden, in Rawls, 'original position' in the social contracts of Locke, Hume and Rousseau. Optimal tax reform must take as its starting point the existing tax system and the fact that actual changes are slow and piecemeal."<sup>3</sup>

This statement underlines the fact that the tax design and tax reform are different and that any tax reform attempt should take for granted certain realities of the existing tax structure, and any changes, if recommended, will be slow in getting injected into the existing tax structure. It also warns the tax reformers that it would be difficult to sell radical tax reform measures in democratic countries, not only because of the operation of the psychological law viz., an old tax is a good tax, but also because of the complex reactions which radical tax reform measures might encounter from the 'self-interest' pressure groups in democracies. Further "tax reform is a continuous process. Not only can no grand once-for-all reform scheme be realistically expected to be adopted, but even if it were it would never be sufficient for very long. Circumstances change, and policies must change with them."<sup>4</sup>

#### EVOLUTION OF TAX STRUCTURE DESIGN

Traditionally taxation was intended to raise revenue for financing the expenditure requirements of 'minimum' government. The expenditure items of 'minimum' government involved mostly 'police state' functions. Such functions of the government did not require sophisticated design of tax structure for the purpose of raising revenue. Most of the required revenue was collected from land owners and from those who carried on trade across borders. Even the early attempts to introduce income tax in U.K., USA and India during the nineteenth century were motivated

by revenue consideration only. The rate structure, exemption and tax base were designed according to the capacity of the administration to identify the tax payer and to reach the revenue target, rather than to promote any socio-political goals.

However, as the society transitioned from 'feudal' form to 'capitalist' form, another objective of taxation (in addition to raising revenue) namely, the objective of reducing inequalities of income and wealth generated by capitalism in the process of its operation, came into prominence. This objective required some sort of tax design. While the function of raising revenue could be performed by any tax, the function of reducing the inequalities of income and wealth required some particular form of tax. Economists started developing socio-political philosophy of reducing the inequalities of income and wealth. To begin with proportional taxation under which equal proportion of tax payment from everybody's income above a limit was justified to achieve the objectives of raising revenue as well as reducing inequalities of income. This was rigorously proved by a Dutch Economist, Cohen-Staart,<sup>5</sup> and later on John Ramsey Mc Culloch,<sup>6</sup> an English Economist, took up its advocacy on the ground of its objectivity. But the range of inequalities created by capitalism was so wide that the proportional taxation could not achieve the objective of reducing such wide inequalities of income and wealth, though it could raise revenue. Hence proportional taxation was questioned both on its dubious objectivity and ineffectiveness. Then progressive taxation came to be justified, first on the basis of socio-political philosophy,<sup>7</sup> then on theoretical and its 'effectiveness' grounds.<sup>8</sup> But this theoretical justification based on diminishing marginal utility of income came to be questioned both on the ground of the impossibility of its measurement and on the weakness of the assumption of diminishing marginal utility of income in the world of ever increasing desires, fashions and the resultant demonstration effect. Even then its effectiveness in achieving the objective of reducing inequalities of income as also its socio-political appeal made it survive all the theoretical and political opposition, and with this the first major stage of tax designing was achieved.

Economists started identifying taxes on income and wealth as direct taxes and taxes on sales, consumption and other transactions as indirect taxes. The first group namely, the direct taxes, were named so on the assumption that they were not shifted on to others and hence borne by those on whom they were levied and the latter group namely, indirect taxes, were assumed to be shifted on to other people by those on whom they were levied and hence the payment of tax was indirect. This distinction was based on the shiftability of tax. When this basis of classifying the taxes acquired currency, economists started putting these two types of taxes to intensive tests in terms of micro-economic analysis. It was argued for a long time that the action of government should not disturb or distort the allocation of resources achieved by the market mechanism in a country and from this it followed that the government should raise its required revenue through such tax or taxes which did not distort allocation of resources effected by the market. In this argument was the implicit assumption that the market mechanism always allocated resources of an economy efficiently. It was proved by using Marshallian partial equilibrium analysis, (later using indifference curve

analysis also), that indirect taxes distorted resource allocation as compared to an equal amount yielding direct tax and hence imposed an excess burden.<sup>9</sup> A direct tax would not affect the price by virtue of the assumption that it cannot be shifted. Accordingly, the direct tax was adored as an ideal tax both for raising revenue and for reducing inequalities of income and wealth. This was a major triumph of economic theory, if it can be called one, in justifying direct taxation for achieving the twin objectives in the early stage of capitalism. This economic justification was used by political propagandists to justify a single tax, though the remnants of single tax programme could be traced to the populist movement of Henry George<sup>10</sup> whose main political motive was to liquidate landlords in the new colonies.

The general equilibrium analysis yielded results which cast doubt on the superiority of direct taxation in the allocation of resources.<sup>11</sup> What is more the empirical studies cast doubts on the very classification of taxes into direct and indirect taxes based on the assumption relating to their shiftability. The evidence tendered before the Royal Commission on National Debt and Taxation<sup>12</sup> in England and the theoretical work of Black<sup>13</sup> showed that direct taxes, particularly business income tax, could be shifted. Besides it was proved by others that comprehensive sales tax when shifted leaves the consumers and the producers in the same position as they were before, and therefore it was as good or as bad as a direct tax. This conclusion cast doubt on the distorting effect of indirect tax on resource allocation.

By the time the technique of tax designing reached this stage, the role of taxation got widened in capitalist economies particularly with the advent of Great Depression. Taxation came to be advocated to be used for achieving stability including price stability, employment stability, output stability and balance of payments stability. This multifaceted stability question required a more complicated design of tax structure requiring high as well as low tax rates, taxes on rich as well as on poor, taxes on profits as well as on consumption at the same time. Price stability required high tax during inflation both on consumption and on profits which could cut into real demand and investment. During depression taxes were required to leave more money in the hands of consumers varying types of direct and indirect taxes to be operated simultaneously. During inflation the tax levers to achieve stability objective were consistent with raising revenue and reducing the inequalities of income and wealth. But during depression this did not happen. Hence, for the first time discriminatory types of taxes were required to be combined and logically integrated and dovetailed. In other words, tax design within the group of direct and indirect taxes were expected to achieve consistency of their effects with the requirements of economic policy objectives. Thus, the evolution of tax designing itself has thrown up the desirable characteristics of a well designed tax structure.

#### CHARACTERISTICS OF A WELL-DESIGNED TAX STRUCTURE

It has been maintained by economists that the following characteristics should be obtained in a tax structure as a whole in order to make it more effective for the purpose of achieving economic policy objectives

mentioned in the previous section. First, built-in-elasticity of revenue yield to meet the evergrowing revenue needs of the government. Second, progressivity in rate structure so as to make the distribution of the tax share of individuals more equitable as also to reduce inequalities of income created by the market forces. Third, planned non-neutrality in the sense that absence of haphazard and random distortion of resource allocation including consumption, investment, saving, leisure etc. And fourth, simplicity in administering the taxes so as to minimise both the cost of collection and the cost of tax compliance. These characteristics should be injected into each and every tax if possible. But in view of the difficulty of creating such an ideal situation, at least the tax structure as a whole should have these characteristics.

#### BUILT-IN-ELASTICITY OF TAX REVENUE

In view of the growing importance of the public sector in both developed and developing countries, the revenue requirement of the governments increases as the countries start moving from one stage to the other higher stage such as for instance, from primitive semi-feudal stage to modern capitalistic stage in the case of developing countries, and from advanced capitalistic stage to post-industrial stage in the case of developed countries. This is more so in developing countries where the governments are supposed to shoulder certain additional functions like creation of social and economic infrastructure facilities and even undertaking entrepreneurial functions. As a result it is argued that a tax structure should yield automatically increasing revenue as the national income increases, without requiring the tax rates, exemptions and coverage being altered every year. Though there is nothing wrong in altering these, it should be remembered that an element of stability and certainty should be injected into the tax structure particularly in regard to the tax rates, exemption and coverage, in order to promote saving and investment. Further, frequent changes in tax rates etc., invite political reactions which may result in tax revolts. Therefore, the democratic countries should have a long-term perspective regarding the tax rates, tax exemption and the coverage of the taxes. At the same time they should be able to raise more and more revenue automatically as the national income increases. Hence, the tax structure should be elastic during the period when the rates, exemption and coverage of the base are kept constant. It has been proved that a progressive rate structure will have a high yield elasticity than other rate structures. Secondly, it has also been proved that the tax revenue which is related to the price of the commodities i.e., the value of the commodities, is more elastic than that related to the quantity or volume of the commodities. In any country where large proportion of income is produced in the unorganised private sector, it is very difficult to have an elastic tax system through only direct tax on income. It becomes necessary to have taxes on commodities also. There again in an attempt to inject an element of progressivity, certain essential commodities will have to be exempted and in view of such narrowing down of the scope of commodity taxation, high rates on commodities of not-so-essential nature becomes inevitable.

Income-elasticity of the taxation also serves another purpose. It acts as a built-in-stabiliser particularly in the case of commodity taxation. As the prices of the commodities increase as a result of taxation, the consumer will have to pay more taxation and consequently the real income will be reduced. This reduces real demand and acts as an automatic stabiliser of prices. The opposite happens when the prices fall. Thus the elastic revenue system not only yields increasing revenue, but also acts as an automatic stabiliser to whatever marginal extent is possible.

#### PROGRESSIVITY OF TAX STRUCTURE

The progressive rate structure has been advocated in most of the countries for reducing inequalities of income and wealth. But it is only in recent years that it has been recognised that the progressive rate structure also serves the purpose of revenue elasticity (and built-in-flexibility) which helps achieving stabilisation objective. Hence, the progressivity of tax structure has been considered as an important characteristics of the structure as a whole. Since progressivity is intended mainly to aim at equity in tax burden distribution, attempts have been made to design taxes to achieve both horizontal, equity, (equal tax burden on people whose economic positions are equal), and vertical equity, (unequal tax burden on people whose economic positions are unequal). However, such attempts have met with only partial success even with direct taxes because of administrative complexities they create. Though commodity taxes have been designed to achieve some kind of vertical equity, it is very difficult to design them for achieving horizontal equity. Therefore, the tax designer has to be content with achieving both vertical and horizontal equity through the tax structure as a whole.

#### PLANNED NON-NEUTRALITY OF TAX STRUCTURE

For a long time the question of absolute neutrality of taxation was considered as an important virtue of a tax and a tax structure. But after the Great Depression when the scope of the objectives of fiscal policy was widened, this emphasis on absolute neutrality lost its importance. Today what is relevant is the absence of haphazard distortion of allocation of resources. For it is accepted today that the market mechanism does not necessarily allocate resources in the economically and/or socially efficient and many other institutional factors. Therefore, the government is supposed to influence the resource allocation in the desired way. The desired way is chosen by the government in the form of priorities in its economic policy and taxation should help the government in influencing the flow of resources in the planned way according to the priorities of the budget of the government, instead of distorting resource allocation haphazardly and creating the traditional excess burden. The planned interference of taxation in influencing the resource allocation is considered as a rational characteristic of taxation particularly in developing countries where market forces are distorted by various types of institutional factors. In such countries taxation should change the relative prices of commodities in accordance with the priorities of the budget. Secondly, taxation should influence the choice between saving and investment, between leisures and income according to the needs



and conditions of the country. This means that both direct and indirect taxes should be used to reduce the demand for scarce commodities and to discourage the flow of scarce factors like capital into the production of luxury goods and socially undesirable commodities. This requires discriminatory commodity taxes which should fall heavily on luxuries and exempt the basic necessities of life. Further, income and corporate taxation should be used to encourage saving in the household and corporate sectors. This in other words means that we cannot achieve socially appropriate allocation of resources through the budget only with one type of tax and hence both direct and indirect taxes, in whatever way we define them, become essential.

Thus in order to inject the characteristics of built-in-elasticity, progressivity and planned non-neutrality into the tax structure, it should include a tax on income, a tax on the value of property, a tax on consumption, or sales of final goods and services. Sometimes it becomes necessary to resort to even certain benefit taxation such as fees, and user-charges even though they are not strictly called taxation. This is because they help in influencing allocation of resources.

#### SIMPLICITY OF TAX ADMINISTRATION

Even the best designed tax structure may fail to achieve its objectives for want of proper administration. Therefore, simplicity of tax administration is a safeguard, though not a panacea, against administrative failure to implement well-conceived tax design and reforms. In this context Richard M Bird observed that "since the quality of tax administration is such an important constraint on the possibility of tax reform, it would appear logical to suggest tax reform which can be administered by a poor administrator. Sound tax policy must be premised on a realistic understanding and appraisal of the capabilities of the tax administration. ... A less than ideal tax designed for a poor administration may work better -- its effects may be more in line with those desired -- than a 'good' tax badly administered."<sup>14</sup>

An important reason for emphasising the simplicity in tax administration is that a tax/tax structure designed to possess the three characteristics, viz., built-in-elasticity, progressivity and planned non-neutrality becomes necessarily complicated. Therefore, to put a check on any further growth of complexity it is necessary to keep the process of administration as simple as it is physically and legally possible.

This requires that (i) the complexity of tax law is kept to the minimum and (ii) administrative procedures are as easy to follow and to implement as possible. These simplifications when achieved will, to a large extent, fulfil Adam Smith's canons of convenience, certainty and economy. The tax administration should suit the convenience of tax payers to pay, and in case of dispute to appeal and to get justice without undue delay. The tax administration should also be able to keep the cost of tax collection and the cost of tax payment to the tolerable limits. The tax law should minimise arbitrary interpretation of the coverage of the tax base, application of the rates and allowance for exemptions and concessions. Thus, simplicity of tax administration is

as important as the other three characteristics of tax design and tax reform in order to create a more desirable tax structure in democratic countries.

#### SOME NEGLECTED ASPECTS OF TAX DESIGN AND TAX REFORM

Though the above outlined four characteristics (or normative criteria) may be considered desirable for the tax structure of any country, "one must design a tax system for the economic, political and administrative conditions which one finds in a particular country and not for some average abstract hybrid of all countries."<sup>15</sup> For, no two countries, whether developed or developing, have the same economic, political and administrative situations and hence tax design and tax reform should be dovetailed with specific country situations.

Further, the old colonial practice of transplanting the taxes of the developed countries along with their tax legislation and administrative structure to the former colonies continued even during the post-war period under the new label of providing technical assistance. Tax experts, who were chosen from developed countries, simply tried to transplant their country's tax institutions to the client country ignoring the changed political situation and economic policy objectives. What is more, some of the tax experts whose fiscal ideas could not find ready acceptance in their own countries tried to experiment them on the client countries with all the disastrous consequences. A monumental example of this kind of Guinea Pig experiment was Nicholas Kaldor's attempt to sell his expenditure tax to India. The failure of expenditure tax in India provided easy evidence for even the developed countries to reject the tax for ever. Similar experiment was evident in Carl S. Shoup's tax proposals for Japan which were considered impracticable.

Furthermore, there are serious limitations in evaluating government's policies in general and tax policies in particular in terms of normative economic criteria alone. Such a framework of analysis is considered inadequate to comprehend the more mundane forces which operate and influence the process of government's policy formulation. This is so especially in the case of formulation of tax policies in democratic political framework.

The political framework within which democratic governments operate are equally, if not more, relevant in deciding about tax reforms. This has been increasingly recognised in democratic developed countries. Accordingly, government policies and programmes have come to be analysed in terms of positive behaviour of governments, politicians, political parties and interest groups, whose operations are conditioned by the prevailing political framework and the economic system, not to speak of many other factors. Here the economic incentives like profit motive, higher income, maximising satisfaction, etc., which are the major determinants of economic behaviour of individuals as well as groups of individuals, are also applied to analyse the political behaviour of politicians, governments, political parties and even bureaucrats. This application of economic theory for the analysis of political behaviour of people and governments has come to be known as public choice theory.

Public choice theory analyses the behaviour of the governments particularly the process of formulation and implementation of fiscal policies so as to understand the actual behaviour and predict future behaviour in terms of this positive approach.

The normative economic approach to tax design and tax reform is based on the assumption that the aim of government in general is to maximise social welfare, or to achieve the objective functions mentioned earlier, and all budgetary tools are intended and used to achieve this objective. This assumption relating to the ultimate motive of a democratic government implies that politicians, and political parties are also motivated by such noble mission. In other words, human-beings whose economic behaviour is mainly governed by their self-interest i.e., maximising income, satisfaction, etc., become selfless social welfare seekers as soon as they are elected to political office and whatever the cost of getting into and continuing in political office, their aim remains noble. But this objective of the government and the basis of it are questioned by the public choice theorists like Anthony Downs,<sup>16</sup> James Buchanan,<sup>17</sup> Gordon Tullock,<sup>18</sup> William Niskanen<sup>19</sup> and others.<sup>20</sup> They have analysed the actual positive behaviour of politicians, political parties, governments and even bureaucrats in terms of the same self-interest theory which governs their economic behaviour. According to the economic approach to the political behaviour, the aim of the government is to continue in power by maximising votes and the main aim of the politicians and even bureaucrats is to achieve higher income, higher status, higher privilege and more power and all government programmes and policies are formulated and implemented with a view to mainly maximising these 'self-interest' motives.

Professor Richard M Bird has interpreted the positive theory of tax reform in the following way: "Since most economic analysis is, in a sense, based on the assumption that individual preferences differ, there should be nothing surprising to economists about this obvious proposition that 'tastes' for tax reform differ also. ... It is thus most unlikely that there would be any readily discernible widespread agreement (or 'consensus') on the desirability of a particular set of reforms. It is the function of politics to conciliate our differing interests and to enable us to live with one another in a tolerable, if not perfect, fashion. The political system thus fulfils with respect to the 'buying' of tax reform the role of the market system with respect to buying of apples."<sup>21</sup> If this is so, then the implications of this approach to tax design and tax reform are far-reaching. For instance, if economic theory justifies planned non-neutrality as an essential characteristic of a tax structure to achieve the economic policy objectives of the government, then the politicians may not implement the required tax reforms if such reforms face the opposition from the pressure groups and/or from the voters in general. If in the calculations of the Finance Minister, the government and the bureaucrats, such tax reforms are going to serve their own self-interest, they might take special interest in implementing them. But such cases arise only by coincidence. Thus if the required tax reforms to improve the effectiveness of the tax structure are consistent with the self-interests of the politicians, and bureaucrats, they will

be implemented. Otherwise, they will be throttled unless strong countervailing forces threaten the very existence of the government.

Thus, even if a government accepts a particular policy on the basis of its relevance for social welfare it may not implement it if its effective implementation would make it lose or weaken its power. Therefore, if a government finds that a particular tax policy is good from the point of view of the country, but if its implementation results in loss of power because of its impact on certain influential sections of the society, then it may announce the policy on paper and implement it indifferently. Therefore, economists should not stop at suggesting appropriate tax reform measures in terms of normative economic criteria. They should analyse the political implications of such measures to guide the political leaders who are to announce their acceptance for implementation, to guide the political party which has to own that policy and to guide the bureaucrats who have to implement it, and suggest appropriate institutional changes as well as practical compromise to achieve the economic policy objectives. This may involve constitutional changes or formal agreement, or strong public opinion.

Therefore, tax design and tax reform should not only satisfy normative economic criteria but also should get over political hurdles in order to make the tax structure achieve the normative objectives of the government in democratic countries. This in other words implies that economists should be able to guide the governments in democratic countries not only in designing an efficient tax structure but also in highlighting the political and administrative problems involved in effective implementation of the suggested tax design and tax reforms. This becomes a self-imposed duty of the advisory committees whether they are specifically asked to do it through their terms of reference or not. More often such advice cannot be sought by the democratic governments openly. Hence, it is necessary to analyse the practical implications and to suggest appropriate alternative policy measures even if it is an embarrassing exercise.

#### FOOTNOTES

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