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Taxing for Peace: Lessons from International Experience

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International theory and practice

In examining the economic considerations that should be taken into account for the legal framework for the eventual peace agreements in Colombia, I found that despite the little that has been written in Colombia on this theme, the international literature has some insights that can at least preliminarily shed light on our case. It is in this way that, despite the fact that the Colombian government since the beginning of the peace negotiations agreed with the guerrillas not to include the economic model in the agenda, it is unquestionable that it has been tangentially discussed, and turns out to be fundamental to the achievement of such a longed-for accord, and for its future stability. Notwithstanding, some countries like Angola and Nepal leave aside the economic causes of the conflicts in order to optimize the negotiation process, others have included them with the objective of discuss in the agreement the necessary institutional and economic arrangements. For example, in the negotiation between North Korea and South Korea, they arrived at a consensus on the contractual items for the best management of natural resources, the source of the economic nature of the conflict.

It is important to specify that the approach of this reflexion is essentially theoretical, and seeks, aside from touching on international experience, to outline some of the legal aspects to consider in the design of fiscal policy that would satisfy post-conflict needs.

In that way, the tensions of an economic nature that arise *iter* conflict have rarely been dealt with by the literature in their pre-conflict phases and during peace negotiations, but have been much studied for the post-conflict period. So then the question that the majority of inquiries that explore the relationship between the economy and peace is, "How should the economy respond to a subsequent socioeconomic situation in a peace agreement to achieve the stabilization of the economy and avoid relapse into conflict?"

The first broad conclusion in the literature, for which empirical evidence exists, is that the size of the State should increase for a post-conflict period to be successful. Carmignani & Gauci (2010), for example, estimate the effect of fiscal policy on the probability of maintaining peace in the post-conflict period in certain African countries. Their results indicate that in this type of transition, the size of the state grows with regard to everything that has to do with the cost of investment and not so much in the state's operation, though sometimes the two go hand-in-hand. Interestingly, it also turns out that the success of fiscal policy depends in essence on the strength of the budget to respond to the new economic needs, more on the side of income — or the "budgetary grants," to use their term — and less on the size of the debt or capital resources.

In second place in the literature is the idea that the interaction between economy and peace requires a good relationship between the economy and politics as well as flexible norms to confront the novelties. So then the policymakers should be able to act within a wide normative framework that allows them to – informed, hopefully, by information as close to perfect as possible – make those distributive and "supportive" adjustments necessary to properly fund the post-conflict period. In the terminology of Carmignani & Gauci (2010), the stability of the peace depends on how the different actors supply their economic needs through the allocation of a peace payoff that guarantees a just distribution in order to maintain the stability of the agreement.

In third place is the macroeconomic policy, which appears to be ideal in responding to the post-conflict social necessities. Some of the macroeconomic policy recommendations for post-conflict periods have been the following:

1. **The necessary increase in revenue, principally taxes**. As mentioned above, it's inarguable that in a post-conflict scenario the size of the state will grow. To be able to defray the cost of the economic necessities of actors reentering civil life, which translates principally into more public benefits allocated by the state, directly or indirectly by means of the private sector, major revenue is required which, according to a large part of the doctrine, should preferably be appropriate to the fiscal reality, rather than indebtedness. It also seems necessary not to depend excessively on the revenue stemming from the exploitation of natural resources;
2. **The re-arranging of expense**. Aside from the fact that over time military expenses will go down after the cessation of conflict, the literature reveals that this decrease will be gradual because of how much in the first post-war phase an equal or slightly lower military cost will be necessary to defend both the peace and the agreements that make it possible. Once past this period there comes the reconfiguration of expenses toward the investments necessary for the construction of a new country, in areas such as health and education;
3. **The growth of foreign investment**. Since in the great majority of conflicts there is a destruction of assets, the literature has focused its post-conflict economic analysis on the necessity of renewing the foreign investment that had left the country because of security concerns, in order to focus that investment on reconstruction and on the creation of infrastructure in peacetime;
4. **A monetary policy and controlled exchange**. Another much-discussed aspect is the control of inflation and the exchange rate, as well as the definition of the functions of regulation and supervision of the financial system;
5. **The design of policies for the formalization of enterprise**. Economic recovery requires the design of lines of credit for small and medium businesses as well as policies to combat informal enterprise. The reduction of transactional costs is also recommended so that the business sector can be the principal driver of the peacetime economy; and,
6. **A proactive fiscal federalism**. In order to repair public finances, it's not desirable to have an excessive dependence on sub-national entities for national transfers. That being the case, the literature suggests that the fiscal strength of these entities is fundamental for the success of post-conflict public finances (Brauer & Dunne, 2010; Carmignani & Gauci, 2010; Wennmann, 2010).

Colombia

For Colombia, in addition to the adjustments to be made in foreign investment, monetary policy and business formalization, among others, greater efforts are required in *fiscal policy* both at national and sub national levels.

Given the inequality and inefficiency of the Colombian tax system, it is inarguable that it must be redesigned in its entirety by means of legal reforms. *Inequality* is the result of the fact that our tax rules are plagued by tax benefits that perhaps once had a social purpose or were simply established by lobbyists, but which in today's time should be eliminated. In recent assessments on the subject, the InterAmerican Development Bank and the World Bank concluded that in Colombia there is a worrying tendency to create tax expenditures, defined as the transference of public resources carried out by the reduction of tax obligations (tax benefits or incentives) with respect to a tax framework (benchmark) (2012, p. 25). According to this investigation:

> "*there are around 200 tax expenditures (TE's) with distinct public policy goals, in income taxes and value added taxes (VAT) … aside from the loss of revenue it entails (estimated to be around* ***25 billion pesos****…), the tax expenditures can have indirect and undesirable effects on economic efficiency and inequality, increasing the complexity of the tax system … (a)dditionally, they increase the cost of administration and compliance, at the same time that they promote new forms of fraud and evasion*" (p. 1, emphasis mine. The figure translates to 9.615 million USD).

The figure above does not take into account the tax benefits included in the tax code for other types of taxes on the national level, nor those defined by Municipal Councils and Departmental Assemblies at the local level.

Inefficiency results from the above as well as from "inflation" or the normative tax dispersion, which causes problems of interpretation and application for actors in the legal realm and which facilitates aggressive tax planning that reduces tax revenue.

In spite of the above, the government insists on partial normative modifications because of the difficult politics of the legislative debate. This being the case, they have recently formed, by legal mandate, a Commission of Experts that will propose gradual tax reforms, taking into account the fiscal policy recommendations that the Organization for Economic Cooperation and Development (OECD) proposed recently. The increase in the rate of sales tax, the establishment of dividends tax (currently deductible in our country), the redefinition of the abused special tax regime (that has more benefits) for non-profit organizations, and the elimination of excessive benefits for some sectors of the economy, are mandatory subjects on the agenda of the Commission.

In conclusion, the Santos government, facing an eventual post-conflict period should "rethink" the financing of essential public services (especially health and education), through a structural legal reform of national and sub-national taxes, as much in substantive aspects as in procedural aspects.

Thus the best alternative is to finance these essential public services through taxes created by the higher levels of economic activity associated with peacetime. In this way, it turns out to be indispensable to normatively direct the tax system towards becoming a system with fewer but simpler taxes, one that therefore is more efficient at raising funds. Such a reform must also bear a sensible study of contributive capacities to guarantee appropriate levels of equality. Moreover, the process of socialization is fundamental; everyone will have to pay for peace and in the end, everyone benefits from the totality of economic activity. This social commitment is still not clear in the national outlook.

On the national level, the proposal would be thus: a only "flat universal income tax for peace", that is to say, eliminating the tax on local industry and commerce or redesigning it (to a "income value added local tax"), and with very few or almost no tax breaks, which consequently results in the taxing of dividends; a single added value tax with a wide taxable base, large tariff, and redistribution via public expense; and a robust wealth tax, eliminating other national (presumptive income) and local taxes which levy wealth components, would be the proposal.

For the subnational system, an efficient mechanism would have to be designed for transferring the above-mentioned national resources to the different territories and to shore up its fiscal strength through updated appraisals of the land registries of real property which are subject to local tax as the Constitution permits. With respect to the other territorial taxes of today, we would have to go over which to include in a subnational tax law to determine clearly the elements of the tax liability.

With regard to tax procedure, the design of less time-consuming processes is fundamental, processes which entail more technical decisions, through special courts for the tax system or by means of establishing tax arbitration, as well as the elimination of recurring tax "amnesties" which are counterproductive in terms of equity.

There is therefore a long way still to go.

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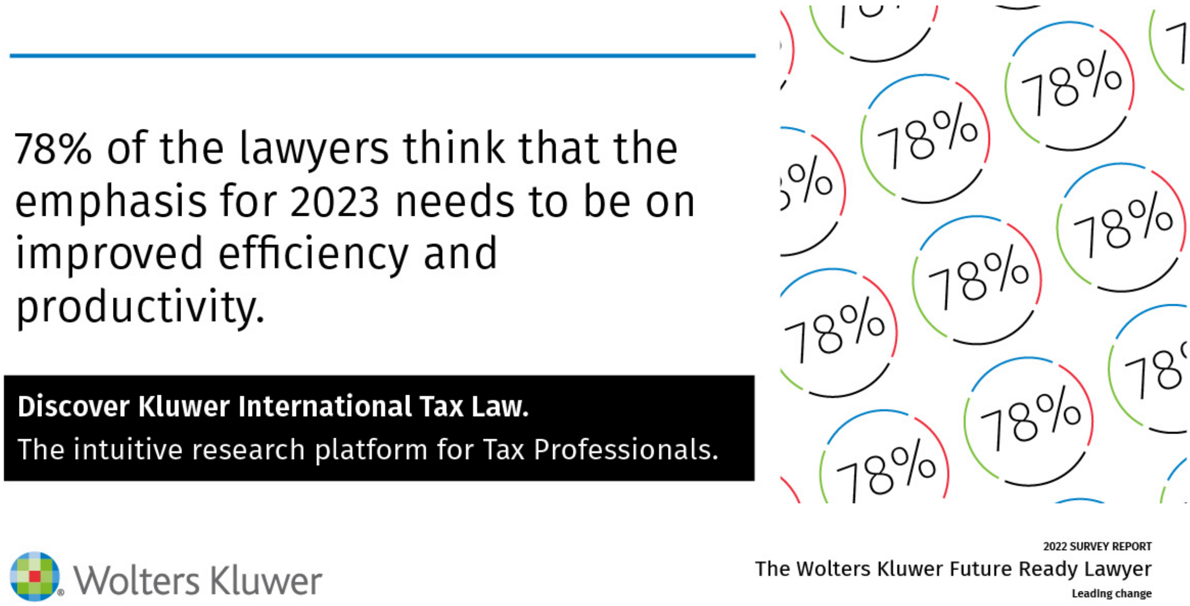

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