Business groups, tax efficiency, and regressivity in Colombia

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Abstract

This chapter discusses the role of business interest groups in tax policymaking. Using the case of Colombia, I argue that tax policy is a limited tool to promote economic growth and redistribution in Latin America because business interest groups have effectively opposed progressive taxation and have also transferred the cost of taxation to low and middle income tax payers. In line with the literature on fiscal contract, this paper shows that the political equilibrium between policymakers and business interest groups in Colombia make progressive and structural tax reforms very unlikely. The case of Colombia is very illustrative of the problems that Latin American governments face to implement progressive tax reforms.

1 Introduction

In the past few decades, Latin American countries successfully increased tax burdens, improved their fiscal stabilization tools, and enhanced tax administration agencies. Despite these achievements, the over-reliance on non-tax revenues and indirect taxation have produced only modest improvements in both tax neutrality and equity. Most recently, negative external factors (e.g. the end of the commodity super-cycle) pose a challenge for fiscal stability in the region and put social achievements of the past decade at risk. The current context of uncertainty in the international environment makes structural tax reforms more urgent than ever. However, implementing structural tax reforms in Latin America has proven to be a challenge and one can count only few instances of substantial tax system overhauls (Focanti et al., 2016). Political economy scholars have studied the complexities of tax politics in the region and provided empirical evidence that the features of tax systems in the region largely respond to the interaction between governments and business interest groups (Fairfield, 2015; Castañeda, 2017). In this chapter, I used the case of Colombia to illustrate the fact that, in general, tax structures in Latin America are slightly more efficient but still quite unfair, and recent tax reforms neither improve vertical nor horizontal equity. These sub-optimal outcomes reflect the nature of the relationship between government and business interest groups and the recent evolution of corporate power in the region.

In particular, I contend that recent transformations in the model of business coordination and political representation (i.e., from a corporatist-like one to a more pluralist-like one) has had a great impact on the relationship between business and the state. Traditional business associations are not the most relevant actors involved in the policymaking process. In most cases, diversified business groups or economic conglomerates play a more relevant role and use completely different channels and mechanisms to influence policymakers. As a result of the emergence and consolidation of these new actors, the policymaking process has become more and more complex, less focused on the executive branch of government, and consequently, structural policy changes are more difficult to achieve.

In other words, I contend that the increasing number of business veto players with capacity to influence policy decisions makes governance in the region more complicated and fragmented; but most importantly, I argue that policy fragmentation makes equitable economic development more difficult to attain. On one hand, the consolidation of a pluralist model of business representation poses serious difficulties for democratic representation. Instead of opening up policymaking to new actors, this new model of business representation concentrates political power on a few number of firms or economic conglomerates with technical and financial capacity to effectively lobby policymakers. On the other hand, business interest groups are less interested in discussing broad policy issues (e.g., economy-wide industrial policies or national development strategies) and focus their attention on narrow, industry-specific, or particularistic policy domains (e.g., consumer or anti-trust regulation).

Therefore, policy fragmentation has become one of the most common features of the policymaking process in Latin America and has substantial consequences for redistribution across the region. In fact, it makes state-business bargaining more difficult and fragmented, and it provides incentives for a regressive fiscal contract. Recent scholarship has provided quantitative evidence on the political dynamics of the fiscal contract in Latin America (e.g. Castañeda 2017, Castañeda and Doyle 2017), but we still need to offer in-depth analysis of the causal business-state relations in the region.

Going down to the country-level of analysis and focusing on particular tax reform scenarios have two main advantages: first, case studies can be treated as ideal types and we can have a better understanding of the causal mechanisms explaining variation in tax policy; and second, country-level observations are ideal for process-tracing analysis.

For the purposes of this chapter, the challenge is to select a case that allows us to understand the interaction among the actors (formally and informally) involved in the tax policy-making process and the consequences of these interactions for tax policy outcomes. I describe the main attributes of the main actors in the tax policy game: policymakers and business community. Once I have specified the preferences and qualities of the actors that bargain over tax policy, I study the interaction between them by focusing on specific tax reforms bills. I show how business communities responded to the government's initiative to increase taxes and how their internal characteristics made them more or less successful than politicians in changing the domestic tax structure. I assess who are the winners and losers in each one of the selected tax reforms and analyze the policy effects of their interaction. This process-tracing analysis aims to uncover the causal mechanism that connects tax policy outcomes with different patterns of business organization. In particular, I show that organizational attributes make business more or less able to counteract the president's advantages in the policy-making process.

The methodological approach described above emphasizes the importance of context-specific policy-making processes and the causal mechanisms that link preferences, incentives, and outcomes. Long-term institutional legacies are taken into account as contextual factors, but they do not constitute the main factors explaining the outcomes of the policymaking process. In other words, I focused on the calculations and preferences of agenda-setters and business interest groups rather than on the historical (or short-term) processes that explain those preferences (Falleti 2010).

Consequently, I use the case of Colombia to illustrate the effects of economic structural changes and increasing uncertainty on tax politics in Latin America. In particular, I show that whilst Colombian policymakers are relatively successful in passing tax reforms through congress, these reforms are never structural and only offer short-term solutions to palliate the constant loss of fiscal space. Tax reforms in Colombia are usually partial and limited in scope. Indeed, most of them are usually known as “quick-fix” tax reforms (*mini reformas tributarias*). I also show that these reforms are always marginal precisely because business interest groups are able to soften any proposals aimed to increase their tax burden or raise corporate taxation.

The case of Colombia is particularly interesting not only because it is one of the main economies of the region, but also because market liberalization was successfully implemented and had important consequences for the relationship between business and state. As I show in this chapter, structural economic changes promoted industrial diversification and business fragmentation, but paradoxically did not diminish business groups’ capacity to shape tax policy and transfer the cost of redistribution to the middle and working class.

Colombia also offers an unparalleled case to study tax politics in Latin America because tax reforms abound but the general tax burden is still lower than the regional average, tax efficiency and equity are still unfulfilled aspirations, and tax administration problems have not been solved yet (OECD, 2015b; Bonilla et al., 2016). In some manner, Colombia represents really well contemporary policy dilemmas in the region: political fragmentation, substantial transformation of business interest groups, and constants loss of fiscal space. It is definitively a good case to help us understand why and how inequitable fiscal contracts are so persistent in the region.

This chapter is organized as follows. First, I briefly discuss the literature on business interest groups and taxation in Latin America. This literature review provides a general framework to understand the role of business in tax policymaking in Colombia. Second, I describe the evolution of tax policy in Colombia between 1990 and 2015. I pay special attention to the evolution of the trade-o between direct and indirect taxation. Third, I illustrate the tax policy game in Colombia by describing the main attributes and policy preferences of policymakers and business interest groups. This section briefly describes the main business associations, conglomerates, and firms that participate in tax policy debates. Fourth, I briefly illustrate the dynamics of the political game and its distributional consequences. Finally, I present some concluding remarks.

2 Business interest groups and tax policy

Despite their indisputable political power, literature on business interest groups in Latin America is rather limited. Seminal works in the field focused on the role of business elites in authoritarian regimes and the relationship between authoritarianism and corporatism (Malloy, 1977; Schmitter, 1974). These works understand the role of business interest groups from a structural perspective more focused on the state-business relationship and pay little attention to the politics of the policymaking process. For these scholars, the study of business interest groups was embedded in broader debates about the inherent characteristics of development in Latin America (Cardoso and Faletto, 1979; Evans, 1979).

In the 1990s, some scholars distanced themselves from these structural views and expended greater effort in the study of business elites during the regional transition to democracy and the implementation of market-friendly policies (Bartell and Payne, 1995; Durand and Silva, 1998; Kingstone, 1999; Malloy, 1977; Payne, 1994; Silva, 1998). These studies focused their attention on the strategies that business interest groups used to navigate the recurring crises of the import-substitution-industrialization development strategy and their capacity to adapt to democratic rule and market-friendly policies of the late twentieth century.

Other scholars have studied other aspects of business influence and their political consequences. For example, Schneider (2004) investigated different patterns of business organization and business-government relations in the twentieth century Latin America and examined the distributional consequences of those relations. From his point of view, the manner in which Latin American states organized their relations with business interest groups into more or less coordinated encompassing business associations had substantial effects on their capacity to implement effective macroeconomic policies and sector governance. Based on this assumption, Schneider has recently presented a theory about the relationship between hierarchical patterns of corporate governance and the persistent inequality trap in Latin America (Schneider, 2013).

Most recently, scholars have sought to address the particular mechanisms that business interest groups use to influence the policymaking process and the organizational factors that enable them to shape public policy. For example, Castañeda (2017) and Fairfield (2010, 2015) explain the bargaining process between Latin American governments and business interest groups that takes place when defining tax policies. They identified various sources of business political power and discussed the consequences for tax policy in the region. For example, some scholars have shown that business interest groups are usually more influential in the policymaking process if the domestic economy depends more on their performance and investment flows (Fairfield, 2015; Campello, 2015). They also predict that business interest groups will be more influential if the domestic economy is less diversified. For example, Castañeda (2017) uses data for all Latin American countries to construct a metric of business structural power (three largest industrial sectors share as a percentage of total national production) and compares it with the degree of openness of the economy. Based on this empirical evidence, Castañeda (2017) finds out that business interest groups in the region seem to be more powerful as the industrial production is more concentrated around some few sectors, especially in those countries where trade liberalization was more gradual.

Organizational attributes are also crucial to explain business political influence. According to Schneider (2013), Fairfield (2015), and Castañeda (2017), business interest groups are influential not only because they are structurally powerful and can credibly threat economic stability, but also because they have resources and organizational capabilities to successfully participate in the policymaking process. For example, Fairfield (2015) uses the classical concept of instrumental power to understand how business interest groups make use of their resources and networks with policymakers to influence policymakers decisions. In the meantime, Castañeda (2017) focuses on the concepts of business coordination and policy integration to understand how business interest groups are more successful than policymakers in shaping the policymaking process.

From this point of view, revenue-raising tax reforms are less likely in the presence of highly coordinated and centralized business interest groups because they can reduce the influence of policymakers on tax policy (Castañeda 2017, 126). When business interest groups are well coordinated, they have political leverage and organizational resources to block tax reform bills in congress. Meanwhile, when business interest groups are not centrally coordinated or poorly integrated to policy-making forums, they will be less able to play the tax politics game and they can only reduce potential impacts on specific industries (Castañeda 2017, 126). In other words, centralized coordination and high levels of policy integration make business interest groups more influential in the tax policy-making process (Castañeda 2017). Also, the effect of business unity is magnified if there is no ideological convergence between policymakers and business interest groups (Castañeda 2017), but also if the party system is relatively unstable or fragmented (von Schiller 2016). In both cases, revenue-raising and/or progressive tax reforms are more difficult to achieve.

Therefore, based on this literature, we can analyze the main features of tax policy as the result of domestic patterns of business coordination and policymakers tax policy preferences. In the following sections, I illustrate these mechanisms using the case of Colombia. But, first, let us describe the main characteristics of the Colombian tax structure.

3 Tax revenue in Colombia, 1990-2015

Tax revenue in Colombia increased substantially over the past 25 years from about 10% of GDP in 1990 to 20% of GDP in 2015. However, tax revenues in Colombia are always below the regional average, which increased from about 15% of GDP in 1990 to 22% of GDP in 2015. The gap is even larger in comparison with OECD countries where average tax revenue oscillates between 32% of GDP in 1990 to 34% of GDP in 2015. In other words, tax revenue in Colombia is quite low given its level of economic development and the size of the economy (OECD, 2015a). In fact, according to the IADB, tax revenues in Colombia are around 4 percentage points of GDP below the expected level for an economy of its level of complexity and economic development (Corbacho et al., 2013).

In terms of fiscal structure, there has been a substantial trade-off between direct and indirect taxation in the past few years. While direct tax revenues decreased from 47% of total tax revenues in 1991 to about 38% in 1996, indirect taxes increased from

50% to about 61% of total tax revenues in the same period. This trend reversed its direction for the first time in 1998-99 and then in 2008-09. In both cases, policymakers responded to negative global market conditions by increasing personal and corporate tax income rates, and by creating new taxes (e.g. wealth taxes, gasoline taxes, etc.). Consequently, the gap between direct and indirect taxation has decreased slightly, but Colombian tax structure is still quite dependent on indirect taxes (VAT and other taxes on goods and services).

For example, almost half of the central government tax revenue comes from indirect taxes. The share of VAT in total tax revenues remains stable between 1990 and 2010, and it only partially decreased in the 2010s. Certainly, VAT rates are relatively low in Colombia (at least in comparison with other countries in the region and OECD countries): there is a large amount of goods and services that are exempt and tax evasion rates are quite high (Bonilla et al., 2016, 38, 115). VAT revenues represented about half of total tax revenues in early 1990s, but their contribution has decreased since 2010 (e.g. VAT revenues were about 40% of total tax revenues in 2015). This is mainly a result of a continuous shrinking of the VAT base (Bonilla et al., 2016, 122) which has substantially reduced its levels of efficiency and productivity (Corbacho et al., 2013; Gomez Sabaini & Moran, 2014).

In the meantime, income taxes are about a third of total tax revenues and their contribution increased slightly since 2010. However, income taxation is relatively low in Colombia (at least in comparison with OECD countries) and most income taxes are levied on corporations rather than individuals (personal income taxes are only 15% of total income tax revenue). On one hand, income thresholds for personal income taxation are high: around 2.8% of the GDP per capita, in contrast with an average threshold of 0.25% of GDP in OECD countries. On the other hand, tax administration privileges payroll taxes over any expansion of personal income tax base. Furthermore, only some few corporations paid income taxes because tax exemptions are numerous. Consequently, income taxes are increasingly paid by a small minority. Some conservative calculations indicate that income tax exemptions could represent about 0.5% of the GDP in 2015 (Bonilla et al., 2016, 56).

Income taxation in Colombia is not only inefficient; it is also quite unfair. The effective tax rate on the top 1% of earners is only 11%, which was the average minimum personal income tax rate in OECD countries in 2014 (Alvaredo & Londoño, 2013; Bonilla et al., 2016). The marginal corporate tax rate remained almost constant since 1990 at 30% of net profits, it increased to 35% of net profits in 1997, then again in 2003 to 38.5% in 2003 to pay for president Uribe's national security strategy (Flores-Macias, 2014), and it was finally reduced to 33% in 2006 during Uribe's second term. Top corporate income tax rates were increased by the Santos administration to 38% in 2014. Meanwhile, VAT rates increased steadily since the late 1980s up to a 16% rate in 1996 and remained constant until the 2016 tax reform when general rate was raised to 19%.

These data seem to suggest that tax burden was higher on consumers during the years of the structural adjustment, and then corporate and individual income taxes increased slightly. However, empirical data shows that this observation is actually incorrect. On one hand, corporate tax rates increased after 1997, but all tax reforms implemented after the financial crisis in 1998 introduced numerous tax exemptions that mostly benefit corporations and affluent Colombians. On the other hand, the VAT rate remained constant almost constant between 1997 and 2015, but the VAT base was sequentially extended to goods and services that were not traditionally subject of taxes like food, medicine, or books.

In the meantime, the national tax agency also improved its administrative capacity to collect VAT and its enforcement capacity to punish VAT evasion. In other words, more poor and middle class individuals were caught in the tax net via indirect taxation, while income tax base narrowed down.

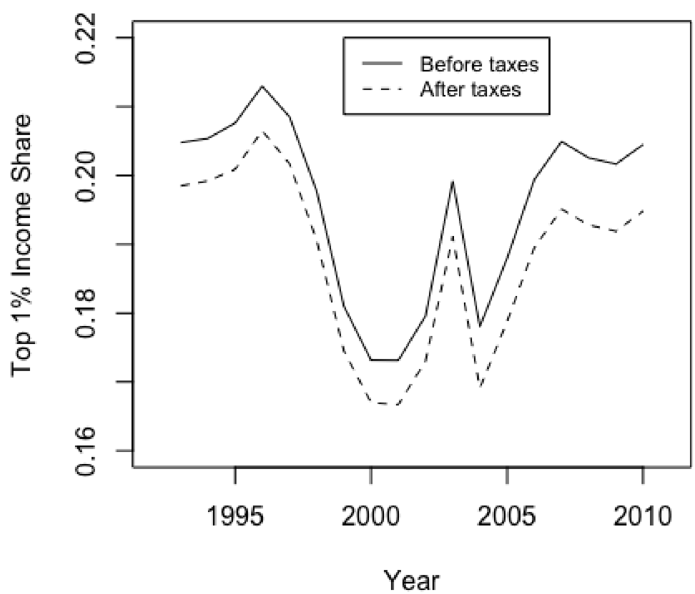

Figure 1: Colombia: Top 1% Income Shares 1990-2012

The narrowing of the income tax base reflects failures of the tax policy (e.g. proliferation of tax exemptions) and has strong consequences for income redistribution. For example, Figure 1 shows that there has been no progress in income redistribution in Colombia: top 1% income share is equal than 25 years ago. But most importantly, Figure 1 also shows that tax policy in Colombia is completely ineffective as redistribution tool: the difference between top 1% income shares before and after taxes is almost none.

The gap between direct and indirect tax revenues seems to shrank not as a result of serious improvements in tax efficiency or fairness, but as an unexpected consequence of favorable macroeconomic conditions (which always have a positive effect on direct tax revenues) and an increasing (but veiled) pressure on consumers and the middle class. A detailed description of the numerous tax reforms implanted in the past two decades provides strong evidence for this argument.

4 Tax reforms in Colombia 1990-2016

Table 1 describes tax reforms implemented in Colombia between 1990 and 2016. In the past 25 years, every president in Colombia implemented at least two tax reforms during their time in office. However, none of these reforms could be classified as a structural or an efficiency-oriented tax reform. Most of them only introduced small changes to the tax structure: small tax rate changes, tax base expansions, implementation of new taxes (e.g. financial transactions tax), or tax administration reforms. One could classify all these reforms as "piecemeal" or "quick-fix" tax reforms only aimed to increase tax revenue in the short-run (Olivera et al., 2010).

The recent evolution of the value-added taxes illustrates quite well the attributes of these "quick-fix" reforms. The VAT was adopted in Colombia in the 1970s to pay for subnational governments expenditures. After the implementation of market-friendly reforms, the VAT became one of the most important sources of tax revenue for the Colombian government. Consequently, it is not surprising that most of the tax reforms implemented since 1990 were aimed to modify VAT rates or extend its tax base (see Table 1).

VAT rates increased from 10% to 12% in 1990, from 12% to 14% in 1992, raised again from 14% to 16% in 1995, and increased to 19% in 2016. Between 1995 and 2016, most changes were rather focused on the lists of items that are subject to VAT. Vehicles, communications, hotels, and air transportation are subject to VAT since 1990; alcoholic beverages (except beer) since 1992; cigarettes since 2000; beer since

Table 1: Tax reforms in Colombia 1990-2016

Year	Government	Law	Modifications
1990	Gaviria	Law 49 1990	VAT basic rate increased from 10% to 12%; tax exemptions reduced; administrative reform
1992	Gaviria	Law 6 1992	VAT rate increased from 12% to 14%; some goods excluded from VAT (i.e. basic consumer basket and some agricultural equipment not produced in the country); income tax rate increased to 37.5%; VAT on capital goods deductible (shift from income to consumption VAT)
1995	Samper	Law 223 1995	Income tax rate reduced to 35%; VAT rate increased to 16%; reduced exemptions for income tax and VAT; strengthened the minimum presumptive income tax regime; tax treatment of commercial leasing defined; capital losses deduction against capital gains tax
1997	Samper	Law 383/1997	Foreign investment and academic research incentives created
1997	Samper	Decree 81/1997	External financing tax created; Stamp tax increased from 0.5% to 1%
1998	Pastrana	Law 488/1998	Broadening corporate income tax base
1998	Pastrana	Decree 2331/1998	Broadening VAT base; VAT tax rate reduced to 15%; financial transactions tax created at a rate of 2 per thousand
2000	Pastrana	Law 633/2000	Broadening VAT base; financial transactions tax rate increased from 2 to 3 per thousand
2002	Uribe	Decree 838/2002	VAT base expansion; net wealth tax created: 1.2% of wealth to be paid once (the so-called "war tax")
2002	Uribe	Law 788/ 2002	Income tax rate increased to 38.5%; broadening VAT base; new sanctions for tax evasion established; new exemptions for specific economic activities
2003	Uribe	Law 863/2003	Financial transactions tax rate increased from 3 to 4 per thousand; net wealth tax re-established ("war tax II"); tax deductions to attract investment established
2005	Uribe	Law 1004/ 2005	Corporate income tax rate reduced to 15% for firms in free trade zones
2006	Uribe	Law 1111/2006	Decreased income tax rates from 35% in 2006 to 34% in 2007 and to 33% in 2008; eliminated dividend tax on non-residents; financial transaction tax made permanent
2012	Santos	Law 1607/2012	Reduced Corporate Income Tax rate from 33% to 25%; reduced capital gains tax rate from 33% to 10%; introduced a new 8% income tax on equity ("fairness tax"); simplify VAT rates to a three-level system: 0%,5% and 16%; broadening VAT base
2014	Santos	Law 1739/2014	Changes in temporary net wealth tax rate; extended new income tax on equity until 2018 and increased rate to 9%; new income tax exemptions; tax amnesty
2016	Santos	Law 1819/2016	Elimination income tax on equity (CREE); Corporate Income Tax rate increases from 25% to 34% and it is scheduled to decrease to 33% in 2018; Increase to CIT rates in free trade zones from 15% to 20%; New 5% income tax withholding on dividends; Financial transactions tax (0.4%) becomes permanent; VAT general rate increases form 16% to 19% and its bases was expanded

Source: PwC Tax Insights from International Tax Services, several years.

2003 (with preferential rates); and security services since 2012. The list of non-taxable items grew substantially since 2000s to include food, raw materials, medical services, public transportation, and public utilities, among others (WB, 2012; Bonilla et al., 2016).

Unsurprisingly, tax policy debates in Colombia usually focus on VAT exemptions and preferential rates, and it is not uncommon to observe sectoral business associations lobbying for VAT exemptions for their products or for industrial sectors that supply them with raw materials.

Table 1 also illustrates the evolution of income taxation between 1990 and 2016. First of all, one can observe that no major changes were made to personal income taxation before 1998. Tax reforms in 1990, 1992, and 1995 only modified tax rates minimally or established new tax credits for donations and investment in strategic sectors. For example, Gaviria's administration increased top marginal income tax rates from 35% to 37.5% in 1992, but this change was reversed by President Samper in 1995. Major changes were made in the late 1990s and the 2000s. In 1998, personal income tax base was extended and several exemptions and deductions were eliminated. Top marginal tax rate was increased to 38.5% in 2002 and new anti-evasion policies were announced. These changes were adopted as part of the government's response to the global financial crisis in 1998 (Sanchez & Espinosa, 2005). Limited access to international financial markets, deterioration of social conditions, and growing unemployment rates demanded major fiscal efforts that could not being afforded by taxing working and middle classes only. Under these new circumstances, increasing direct taxation seemed unavoidable and conservative governments responded consistently (Sanchez & Espinosa, 2005).

However, high income tax rates did not last long. In 2003, Uribe's government announced numerous tax deductions and exemptions for investment in strategic sectors. In 2006, income tax rate was reduced to 35% and Congress approved a gradual reduction from 35% in 2006 to 33% in 2008. In other words, Uribe's government temporary increase tax pressure on personal and corporate income taxation for economic recovery purposes, and then such pressure was gradually reduced once the crisis was over and the country (like most of its neighbors) entered into a new, almost unexpected path of economic prosperity. This additional tax effort also contributed to finance the national security strategy aimed to military defeat leftist guerrillas (Flores-Macias, 2014). In 2012, Santos administration implemented new reforms aimed to reduce personal income rates from 33% to 25% and created an additional income tax (*Impuesto Minimo Alternativo Nacional*) for taxpayers that receive net salaries greater than US$1,800/month.

Like in the case of VAT, tax reforms have mostly changed income tax base rather than rates. In other words, introducing tax deductions and exemptions is more common than creating new tax credits. The case of corporate income taxation is quite illustrative. A number of tax deductions for investment in scientific research were approved in 1992. Tax exemptions were created for foreign investment funds, non-profit organizations, educational institutions, religious organizations, and political parties in 1995. Corporate income tax base was extended and maximum rate was raised from 30% to 35% as part of the 1998 austerity plan. The 1998 tax reform also included generous tax deductions for "job creators." Uribe administration established a net wealth tax of 1.2% on individual property and increased corporate income tax rate to 38.5% of net profits in 2002. However, the main purpose of his first tax reform was to establish numerous tax exemptions for palm oil production, foreign direct investment, and free trade zones. In his second term in office, Uribe reduced corporate tax rate to 33% and temporary tax exemptions were permanently included in the tax structure. As mentioned above, president Santos also reduced the top corporate tax rate from 33% to 25% in 2012. Observe that lower corporate income tax rates were usually compensated with the adoption of new, temporary taxes that were presented to the public opinion as distributive fiscal tools, but actually had quite regressive effects on small business and the middle class (e.g. financial transactions tax, net wealth tax or "war tax", or "equity tax").

The examples above show that tax reforms in Colombia are not only quite frequent but they are also biased towards indirect taxation and introduce significant distortions in personal and corporate income taxation. The main consequence of this policy bias is that tax burden shifted to the middle and lower class. In other words, the Colombian tax system is not only inefficient (tax revenues are relatively low), but it also upside down and unfair with poor people and middle classes paying more and rich people and corporations paying less (see Figure 1).

5 Business groups, policymakers, and unequal fiscal contracts

Why is Colombian tax system upside down? Fiscal policy in Colombia is inefficient and unfair because, whilst Colombian policymakers are relatively successful in passing tax reforms, these reforms are usually conceived as short-term policies to palliate the persistent loss of fiscal space and not as structural policies aimed to support countercyclical fiscal policies and reduce inequality. In the section above, I show that tax reforms in Colombia are usually partial and limited in scope. In this section, I argue that these reforms are partial and limited because business interest groups in Colombia have been able to soften any proposals aimed to increase their tax burden. In other words, tax politics does not promote tax efficiency or fairness. Thus, in order to understand the distributional consequences of tax politics in Colombia, we need to have a clear idea of policymakers and business interest groups policy preferences and how they interact to each other in the policymaking process.

5.1 Policymakers

The policy preferences of policymakers are the first entry point to tax politics in Colombia. We could reasonably contend that no matter their partisan allegiances or their ideological agendas, policymakers in Colombia usually prefer to increase fiscal revenues rather than cutting government expenditures.

Table 2 describes Colombian presidents' ideology and partisan powers (i.e. size of their legislative coalitions) between 1990 and 2016. During this period, most of the presidents and the members of the economic cabinet were somewhat affiliated to either the liberal or the conservative party (or political movements closely associated to these parties). They could be certainly classified as center-right or right-leaning politicians.

Data presented in table 2 also suggest that their fiscal policy preferences are not correlated to their ideological or partisan affiliations. Recent presidents were somewhat affiliated to the two traditional parties: liberal and conservative. Cesar Gaviria (1990-1994), Ernesto Samper (1994-1998), and Juan Santos (2010-2014) are important figures within the Liberal Party. Meanwhile, Andres Pastrana (1998-2002) and Alvaro Uribe (2002-2010) are somewhat connected to the Conservative Party. Ideological distinctions between both parties (Liberal and Conservative) were relative clear before the late 1950s, but they practically disappeared after three decades of power-sharing democracy - the so-called *Frente Nacional* (Hartlyn, 1988) and decades of electoral fragmentation made ideological differences disappear (Dargent & Munoz, 2011).

Political economy scholars suggest that right-leaning politicians are more prone to fiscal discipline, and more willing to reduce expenditures and taxes (Alesina et al., 1992; Alesina & Rosenthal, 1995). However, this is not the case for right-leaning

Table 2: Colombia: president's ideology and partisan power, 1990-2016

Term	President	Party	Ideology	Partisan power*
1990-1994	Gaviria	Liberal	Center-right	Fairly strong
1994-1998	Samper	Liberal	Center-right	Fairly strong
1998-2002	Pastrana	Conservative	Right	Weak
2002-2006	Uribe	Primero Colombia	Right	Strong
2006-2010	Uribe	Primero Colombia	Right	Strong
2010-2014	Santos	Unidad Nacional	Center-right	Strong
2014-2016	Santos	Unidad Nacional	Center-right	Strong

*Size of the government coalition. *Source:* (**?**)

politicians in Colombia (and arguably in Latin America). Fiscal conservatism is not an essential part of the rightist political discourse or its policy version in Colombia. Indeed, in contexts of fiscal stress, they usually prefer to increase taxes rather than adopt radical programs of spending reduction. The explanation is rather simple. On one hand, there are no political incentives to praise fiscal conservatism because there are no challengers (with real chances of getting elected) credibly promising austerity. On the other hand, Colombian rightist politicians can easily claim credit for the implementation of a number of social and poverty alleviation programs (Gonzalez, 2011; Baez et al., 2012), so they have strong incentives to increase public spending.

So, if they have similar preferences regarding public spending, are their tax policy preferences any different? They are indeed. In fact, one can distinguish among them by their preferences about taxation. All of them seem to prefer raising revenues as the best fiscal-reduction policy tool, but some are more concerned about tax efficiency while others are more worried about equity. The first group is more concerned about the effect of taxation on productivity and competitiveness. From this perspective, the purpose of any tax reforms should be always consistent with the economic principle of promoting and protecting domestic and foreign investment. Then, tax reforms should be focused on reducing direct taxation and increase indirect taxes. The second group is more concerned about the effects of taxation on inequality (at least, they frame their attempts to reform the tax structure as policies to reduce inequality). Then, tax reforms should focus on the negative impact of indirect taxation on redistribution and collect more direct taxes.

Unfortunately, research on policymakers tax policy preferences in Latin America is only an emergent field of research (Castañeda, 2017; Stein & Caro, 2017). Therefore, we need to assume that partisan cues are enough to fully identify policymakers' preferences.

5.2 Business interest groups

The theoretical framework presented in section 2 suggests that business power can be understood as a combination of structural and organization (instrumental) power. Based on this framework, one can describe business interest groups political power in Colombia.

First of all, on can observe that economic openness increased substantially in Colombia, especially in the 2000s when trade liberalization seemed more consolidated and the government made substantial efforts to build new trade partnerships with other Latin American countries, China, and the United States (Ramirez, 2005). However, higher levels of trade openness did not necessarily translate into higher levels of industrial diversification. The economy became more open to external trade, but domestic industrial structure remained quite concentrated. In other words, economic liberalization did not necessarily translate into industrial transformation, and it only changed ownership patterns at the firm and industry level (Garay, 1998; Misas, 2002; Garcia Isaza, 2005; Jaramillo & Parra, 2012). Thus, one could reasonably argue that business interest groups in Colombia are market-powerful because domestic industrial production is not only weakly diversified but also because there was not significant changes in the industrial structure.

On the other hand, one could reasonably demonstrate that business' organizational power is rather low in Colombia. There is an economy-wide, encompassing business association - *Consejo Gremial Nacional (CGN)* - that represents the most important industrial sectors in Colombia (about 60% of the domestic industrial production). However, the CGN is institutionally weak, does not have strong linkages with the state (it relies on social or personal networks), and does not have real capacity to enforce any decisions among its members. In fact, the CGN does not have its own headquarters and is poorly staffed. The CGN's coordination committee, integrated by executives from all affiliated sectoral business organizations, makes consensual but not enforceable decisions. In other words, the CGN only works as a coordination mechanism to influence public opinion, but it has not real power for policy-making purposes.

Business political power comes from sectoral associations and economic conglomerates (*grupos*) because they are better organized, better staffed, and better resourced for political influence activities. This particular pattern of business coordination has strong consequences for business political influence. The CGN can frame public opinion regarding some policy issues, but it does not have actual operational capacity to undertake any complex political maneuvers like lobbying or making financial contributions to political campaigns. Therefore, top executives from sectoral associations and economic conglomerates usually undertake these tasks. Additionally, the CGN's decisions are effective only if there is a consensus among all sectoral associations about the policy issues under debate. Otherwise, every sectoral association displays its own strategies and political influence activities.

The relationship between business associations and economic conglomerates is a second source of institutional weakness. The *Ardilla-Lule* group consists of several firms operating in the manufacturing and media industries. The *Santo Domingo* group focuses its activities on media and financial holdings. The *Sarmiento-Angulo* group concentrates several firms in the banking and construction sectors. The *Sindicato Antioqueño* group consists of several firms operating in the manufacturing sector. Several insurance companies integrate the *Bolivar* group.

Like in most of countries in the region, the emergence of economic conglomerates constitutes the most important transformation of the Colombian industrial structure in recent years (Garay, 1998; Peres & Garrido, 1998; Misas, 2002). They have displaced traditional business associations as the dominant actors in the policy-making arena and gained control over large portions of domestic production and external trade. By making large financial contributions, economic conglomerates have taken over a number of sectoral business associations and their executive boards (Rettberg, 2005). Consequently, economic conglomerates have become strong veto players within sectoral and economy-wide encompassing business associations. For example, the influence of the *Grupo Santo Domingo* and the *Grupo Ardila-Lule* on the decisions made by the industrialists association (ANDI) is indisputable (Rettberg, 2003, 2005).

Economic conglomerates also have strong incentives to run political operations outside the umbrella of the formal business organizations. Their increasingly generous campaign contributions give them direct access to politicians and bureaucrats in both executive and legislative branches. Although data about campaign contributions are not transparent in Colombia, different journalistic sources show that economic conglomerates (or *grupos*) are the main donors in presidential and legislative electoral contests (Lewin & Rudas 2013, Transparencia por Colombia 2014, 2016). As sectoral business associations are not legally allowed to contribute to electoral campaigns, most of the corporate donations are channeled through individuals or firms connected to the economic conglomerates.

Thus, political finance regulation in Colombia makes economic conglomerates quite influential for the policymaking process. In fact, it is not uncommon to find CEOs and top executives from the economic conglomerates meeting legislators or actively lobbying in congress. For example, the Bavaria's CEO (one of the *Grupo Santo Domingo*'s flagship firms) personally organized the pro-business legislative caucus that opposed the 1992 tax reform (Parra, 2004). The presence of economic conglomerates in congressional and technocratic discussions is regular, "institutionalized," and increasingly professionalized (the number of professional lobbyists who work directly with legislators and regularly attend committee hearings and general floor meetings has risen substantially in the past two decades).

Before the predominance of the economic conglomerates, business lobbying was controlled by a small group of former cabinet members, former legislators, and prestigious lawyers. Lobbying was a matter of networking, not a matter of resources. Firms and business associations usually hired individuals with strong personal connections with the president, cabinet members, or pivotal legislators. Lobbying was based on complicated networks of personal favors and patronage established between members of the political and economic elite (Rettberg, 2003, 2005).

Market liberalization made these traditional lobbying strategies completely obsolete. The emergence of new, powerful, and complex economic conglomerates required more sophisticated strategies for political influence (Parra, 2004). On one hand, the owners of the economic conglomerates were not necessarily members of traditional upper classes in Colombia. For example, Carlos Ardila-Lule and Luis Carlos Sarmiento Angulo were raised in middle class neighborhoods and their fortunes were not inherited. Their social connections with traditional political elites are relatively new (at least, in comparison with Julio Santo Domingo or the members of the *Sindicato Antioqueño* who inherited their fortunes and were part of the aristocracy since the late 1800s). Consequently, their linkages with political and bureaucratic elites were not as fluid as their counterparts in the traditional business associations (e.g. coffee growers).

A new industrial and economic structure requires policymakers and lobbyists with higher levels of technical expertise. For example, financial and tax regulations are far more sophisticated after market liberalization (Abascal et al., 2011). Thus, traditional lawyers (usually specialized in constitutional, civil, or criminal law) are not prepared anymore to deal with the complexities of the financial and capital markets. In other words, there are strong incentives for the professionalization of lobbying activities and this explains the recent boom of the consulting and lobbying sector in Colombia.

In summary, the pattern of business organization in Colombia can be described as one in which business centralization and unity is relatively weak and sectoral business associations are influential, operationally efficient, and relatively autonomous. Additionally, economic conglomerates are becoming dominant actors and have taken over sectoral and encompassing associations. Finally, lobbying firms are becoming increasingly powerful and influential. In other words, business political influence activities are less institutionalized but more professionalized. Consequently, economic conglomerates and individual firms are more influential than sectoral and economy-wide encompassing associations. Colombian business interest groups are definitively moving towards a more pluralist, fragmented model of business representation.

5.3 Pluralism and tax policy

The evolution of business interest groups towards a more pluralistic model of business organization explain why a large number of tax reforms have been adopted in the past two decades and why those reforms are always partial rather than structural. In particular, we can argue that business interest groups in Colombia seem to be quite successful in diminishing the scope of tax reforms, however, their political influence and level of organization is not enough to completely kill them. Therefore, better resourced sectoral associations and economic conglomerates focus their attention on two policy issues: i) preventing any increases in the top marginal corporate tax rates, and ii) protecting or gaining tax exemptions and credits that benefit their industrial interests. They do not engage in broad debates about the principles of tax policy or its effects on economic development and redistribution. They focus on narrow, particularistic goals. Their capacity to accomplish such goals depends on their own resources and their access to the policymaking process.

Therefore, tax reforms in Colombia are always narrow and unfinished because both policymakers and business sector are not powerful enough to impose overwhelming victories. On one hand, low levels business coordination in Colombia indeed facilitates the recurrent implementation of reforms, but it also creates serious obstacles to the implementation of a consistent or coherent tax policies. Business interest groups are not coordinated enough to permanently stop government's attempts to increase the tax burden; however, they are strong enough (at the sectoral-level and the conglomerates-level) to introduce hundreds of tax loopholes aimed to protect the interests of particular industries. On the other hand, Colombian policymakers, always looking for new sources of tax revenue are relatively successful in implementing tax reforms. However, they do not have enough partisan and constitutional powers to implement structural reforms. Or their links to the business sector are stronger than their policy preferences and needs.

Unlike other countries in Latin America, in Colombia sectoral and industry interests prevail over economy-wide interests, and business centralization is more formal than functional. Thus, the emergence of a fragmented model of business organization provides strong incentives for business interest groups and politicians to embrace complex, inefficient, and unfair tax structures. On one hand, the emergence of economic conglomerates and the persistence of some sectoral business interests increased the number of veto players involved in tax policy-making and causes policy fragmentation. On the other hand, tax policy bargaining is so complex that only few players can effectively participate and push their interest.

This situation is quite disadvantageous for unorganized and not well-resourced interest groups or groups of citizens. Policymakers (in a constant quest to increase revenues) respond to policy fragmentation by transferring the costs of taxation to groups that are not well represented in the policymaking process or do not have enough resources for lobbying or funding electoral campaigns. In a context of fiscal stress, income tax exemptions and deductions, and shrinking income tax bases are replaced with more indirect taxation and partially regressive new tax schemes. If facing a trade-off between efficiency and equity, Colombian policymakers seem to prefer increasing revenues and avoiding economic distortions than distributing tax burden fairly among taxpayers.

As I discussed above, this is not a policy decision merely based on ideological or partisan criteria; it is a policy response to the structural attributes of the economy and the patterns of business representation. In others words, the institutional complementarities across different spheres of the economy shape the attributes of the fiscal contract in Colombia and explain the persistence of inefficient and unfair tax policies.

6 Concluding remarks

The lack of fiscal space has been a major constraint for macroeconomic stability in Colombia. Most governments have proposed raising tax revenues and implemented several tax reforms since the early 1990s. However, none of these reforms are structural and their impact on efficiency and equity is rather limited.

In this chapter, I argue that the political influence of business interest groups could partially explain the limitations of tax policy as a policy tool for economic growth and redistribution. It is increasingly difficult to implement structural tax reforms not only because legislative bargaining is increasingly complex, but also because more business actors are involved in the process. Unlike the previous corporatist-like model, policymakers negotiate tax policy with an increasing number of business interest groups. Instead of negotiating broad policy agendas or highly salient issues, highly-fragmented business interest groups lobby for industry-specific tax exemptions, sector-targeted tax deductions, or specific preferential treatment to capital income. And consequently, only business interest groups with privileged access to policymaking networks or sufficient resources to fund lobbying and electoral campaigns accomplish their goals. Meanwhile, under-resourced business interest groups (or interest groups, in general) are exposed to increasing tax burdens on their economic activity. Non-organized citizens are less resourced than diversified business groups, and consequently, they are often defeated in the policymaking process and pay the costs of fiscal austerity policies.

This new political arrangement definitively shapes the fiscal contract in Colombia. On one hand, it opens the window for indirect taxation to become the main source of tax revenues. On the other hand, corporations and affluent individuals find mechanisms to circumvent high income tax rates and transfer the tax burden to the less-organized and less-influential middle classes. Therefore, Colombian reformism does not strike any balance between efficiency and equity. On the contrary, it perpetuates an unsustainable fiscal contract.

The study of the Colombian case allows us to formulate some hypotheses about the fiscal contract in Latin America. First of all, this case illustrates quite well the evolution of business interest groups in the region. As Schneider (2013) has carefully demonstrated, the emergence of diversified business groups in the region transformed state-business relationships and has important consequences for the implementation of fiscal, industrial, and social policies. This chapter illustrates how pluralistic models of business representation shapes policymaking and limits government's capacity to deal with fiscal pressures. Second, the analysis of the Colombian case also illustrates quite well the effect of changes in state-business relations on the regional fiscal contract. As I have shown in this chapter, the most important actors for fiscal policymaking, policymakers and business interest groups, face incentives that make very difficult to implement progressive tax policies or to simply use tax policy to reduce inequality. As Mahon et al. (2015) have recently discussed, the political economy of tax reform makes almost impossible to introduce progressivity in the tax structure. This chapter provides an explanation focused on the role of the elites and their effectiveness to resist direct taxation and prevent the development of state capacity. The lack of progressivity in Colombian is not exceptional in Latin America. In fact, the Colombian fiscal contract exemplifies quite well the challenges societies face to implement progressivity in taxation in the most unequal region of the world.

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