

Strengthening Peru's tax agency

Peru's semiautonomous revenue authority is one of the developing world's most successful examples of tax administration reform. Why? And what are the implications for other developing countries?

Before reform, Peru's tax administration was riddled with corruption and on the verge of collapse. The tax agency neither recruited experienced professionals nor provided training. Salaries were low, yet the wage bill was high due to overstaffing. Most general directors were political appointees whose tenure averaged less than two years. Moreover, the agency did not have adequate resources to finance its operations, let alone invest in infrastructure. As a result tax collections declined, a trend exacerbated by the economic crisis of the late 1980s. Tax revenue dropped from 14 percent of GDP in 1978 to 9 percent in 1988. Frequent organizational restructurings did nothing to improve performance.

In this context serious attention was given to radically reforming—even recreating—the tax administration. Building on the legal framework established by his predecessor, President Alberto Fujimori decided to pioneer the concept of a semiautonomous revenue authority, the first in Latin America. The revenue authority's core reform team, which did not include any tax administration experts, was seconded from the central bank and brought with it an appreciation of the importance of professionalism and bureaucratic autonomy.

The reforms were remarkably successful: by 1997 internal tax revenue had recovered to 13 percent of GDP—despite an extremely difficult political and economic environment—and 90 percent of large corporate taxpayers surveyed believed that taxpayer services had improved. The reforms

had several key elements: granting the National Tax Administration Superintendency (SUNAT) meaningful administrative and financial autonomy, implementing radical personnel reform, investing in infrastructure and information technology, and generating public support.

The foundations of SUNAT

The government of Peru decided to overhaul tax policy and tax administration at the same time. Tax policy set out a large number of taxes coupled with extensive exemptions and incentives. The reforms aimed at streamlining and simplifying the system: income tax rates were reduced, exemptions were eliminated, and the sales tax was replaced by a value added tax.

The administrative reforms rested on a few key pillars. First, SUNAT's personnel system was exempted from civil service regulations and allowed to operate along private sector lines. Second, SUNAT's superintendent became a presidential appointee, reporting directly to the president on matters of import. Third, SUNAT's budget was set at 2 percent of collections, and the funds were automatically deposited in the agency's accounts. These features were intended to empower management while insulating it from political interference, imbue staff with professionalism and integrity, and ensure the timely and predictable provision of budget resources.

The reforms also forged a new relationship between taxpayers and the tax agency. SUNAT pledged to treat all taxpayers fairly

Peru overhauled its approach to tax policy and administration—with impressive results



Financial and administrative autonomy was crucial

and committed to improving services. At the same time, the agency made clear its intention to enforce compliance with the tax code. SUNAT communicated its “new deal” to taxpayers through a sophisticated public relations campaign. The agency’s new managers understood the importance of earning public support for reforms, and this support was cultivated through better services—delivered through service centers located throughout Peru—and honest administration. In turn, the public’s interest in SUNAT’s work became a powerful motivator for the agency’s staff.

Improving human resources

The reform team, led by Superintendent Manuel Estela, was convinced that the first step in a serious reform program was to address personnel, given the problems of overstaffing, low salaries, and low morale. Based on President Fujimori’s 1991 executive decree, which called for the reorganization of SUNAT, the reform team developed a plan for a comprehensive staff evaluation and replacement program.

SUNAT’s managers were committed to selecting and developing an honest, professional staff. As such all staff members, who were inherited from the previous agency, were given the choice of either opting for voluntary retirement or applying for a position in the new SUNAT. Those who applied were subject to a three-phase exam. The first phase consisted of a psychological evaluation that focused on personality, intelligence, and moral judgment. The second phase evaluated knowledge, reasoning, and professionalism. The third phase consisted of personal interviews. Additional information from third party sources, such as the public register and the general accounting office, was also used to evaluate the suitability of existing staff for employment in the new superintendency. Only those who satisfied all these requirements were rehired.

Despite strong resistance from the union and staff, SUNAT managed to carry out the initiative, which sheared two-thirds of its staff. The number of employees fell from 3,025 to 991, with 1,604 staff members opt-

ing for a generous voluntary retirement program and 430 failing the exam.

The final step was to recruit about 1,000 new staff members through a rigorous selection process at Peru’s most elite private universities, bringing the number of employees to the needed 2,000. The staff replacement program was not cheap: costs exceeded \$2.3 million. SUNAT financed part of the initial reforms with resources set aside in 1988 for that purpose. Given the results, however, the investment in personnel reform proved a small price to pay.

But the staff evaluation and replacement program was just the beginning. The new management team recognized that a professional personnel system would be instrumental to the reform’s success. As part of SUNAT’s autonomy, it was allowed to operate under private sector labor laws, permitting the agency to design its own personnel system. To boost morale and efficiency, SUNAT decided to pay salaries based on comparable employment in the private sector. As a result the average monthly salary jumped from \$50 to \$1,000. The new salary policy also included a provision to maintain the competitiveness of SUNAT’s salary structure relative to the private sector.

Ensuring financial autonomy

To guarantee SUNAT’s autonomy, a new financing mechanism was designed—though not without some controversy. Despite serious concerns about the effect a special funding mechanism would have on other public organizations, SUNAT’s founding law specified three basic sources of income: 2 percent of taxes collected by SUNAT for the treasury, 25 percent of revenues from auctions of taxpayer property, and 0.2 percent of taxes administered by SUNAT but not constituting treasury revenues. In one regard this funding mechanism was much different from those later used in other Latin American countries: the 2 percent share of taxes collected by SUNAT was automatically deposited in the agency’s accounts, eliminating intervention by the treasury. This approach proved to be an important source of financial stability.

Avoiding political interference

SUNAT became one of the developing world's few semiautonomous revenue authorities able to operate without undue political interference. This was mainly due to the special interest President Fujimori initially took in the agency's operations, as rapid, substantial, and visible improvements in tax collection became a top priority for the Peruvian president. In no other country had a new autonomous revenue authority received as much presidential support as in Peru.

In addition, because President Fujimori did not face pressure from an established political party to dispense patronage, he had less reason to interfere in SUNAT's personnel system. More than 97 percent of agency staff were hired according to meritocratic procedures; the rest were appointed by SUNAT's superintendent. The Peru case thus differs from many other developing countries, where the tax administration is regarded as a prime source of patronage.

At the same time, tax administrations sit squarely in the political economy nexus of state-civil society relations, and SUNAT is no exception. The reform generated conflict over tax policy because the agency became heavily involved in policymaking—for example, it played a large role in drafting the value added and reformed income tax laws. On one hand, SUNAT's involvement was partly due to the fact that it had more sophisticated analytical capacity than the Ministry of Finance. On the other, it was due to SUNAT's interest in promoting technically based tax policy reforms. Tensions between SUNAT and the ministry came to light when, starting in 1995, Fujimori's interest in SUNAT waned. As a result SUNAT lost influence over tax policy, which led to the undermining of policymaking by political considerations.

A model for an autonomous revenue agency?

SUNAT's experience offers several lessons for tax administration reform in other countries. First, the immediate efficacy of SUNAT as a semiautonomous revenue authority was due to a combination of sev-

eral factors, perhaps the most important of which was a coupling of political leadership with managerial expertise. The impact of direct presidential support for the reform should not be understated. Moreover, management of the reform benefited from both a team of professionals with experience in an autonomous organization and technical expertise from external consultants with international experience.

Second, the comprehensive approach contributed to the reform's success. Reformers drafted a master plan that coordinated reforms in tax administration and tax policy. A reform committee was established to monitor progress weekly and respond immediately to problems during implementation.

Third, SUNAT's organizational design allowed for managerial flexibility on a host of important issues from personnel to financial administration. SUNAT's financial and administrative autonomy was instrumental in allowing management to establish a merit-based personnel system and secure adequate, predictable funding. The revenue authority model worked well in the Peruvian context because it empowered professional managers to carry out far-reaching efficiency and integrity-enhancing reforms while maintaining accountability to the government.

Fourth, despite resistance to radical personnel reform, the vision of SUNAT's senior managers prevailed: they created an organization based on high ethical and professional standards, which they maintained by fostering an organizational culture based on a sense of dedication to the agency's mission.

Fifth, SUNAT's strategy of coupling its fight against tax evasion with better taxpayer services enabled it to develop a constituency of supporters in the business community. Many of Peru's large corporate taxpayers respected and valued SUNAT's work, giving the agency some protection from political interference.

But Peru's experience also highlights pitfalls to avoid for other countries engaging in tax administration reform. One is that

Political leadership and managerial expertise explain much of SUNAT's success

Tax administration
reform cannot occur
in a vacuum

the relationship between the tax agency and the ministry of finance should be carefully managed. In Peru this relationship has been strained and at times conflictual. The absence of a clear division of labor on tax policy and sharp differences in organizational cultures contributed to the tension between the two organizations.

Sustainability is another aspect of revenue authority reform that merits careful attention. Despite SUNAT's initial success, several problems have emerged. First, tax policy has been undermined by a series of tax exemptions, amnesties, and loopholes, especially in the income tax. The deterioration of tax policy has had negative consequences for SUNAT, which finds it increasingly difficult to collect taxes fairly and efficiently. Second, several well-publicized cases of political persecution based on the misuse of confidential tax information have led to the belief that SUNAT has been infiltrated by political operatives, though recent political change offers hope for the agency's long-term prospects. Third, just as the tax administration requires good tax policy and political support to function effectively, it also depends on the greater institutional environment. SUNAT's effectiveness has been limited by the weaknesses of other institutions—notably the judiciary and the police. For all these reasons, SUNAT has suffered a loss of standing in public opinion.

The Peru case shows that tax administration reform cannot occur in a vacuum. And while SUNAT's success makes a strong case for a semiautonomous revenue author-

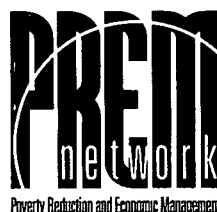
ity, it underscores the need for long-term political support to ensure sustainability. Autonomy alone may be insufficient to safeguard against political interference while maintaining integrity and professionalism.

Further reading

- Estela, Manuel. 2000. "Strengthening the Integrity of a Tax Collection Agency: The Case of SUNAT in Peru." Paper prepared for a World Bank–Inter-American Development Bank seminar on "Radical solutions for fighting corruption in the public sector," 2–3 November, Washington, D.C.
- Taliercio, Robert. 2000. "Administrative Reform as Credible Commitment: The Link between Revenue Authority Autonomy and Performance in Latin America." Paper prepared for the annual meeting of the American Political Science Association, 31 August–3 September, Washington, D.C.

This note was produced by the World Bank's Tax Policy and Administration Thematic Group in cooperation with the Inter-American Development Bank's Fiscal Division. It was written by Robert Taliercio (Young Professional, PREM Sector Unit, East Asia and Pacific Region) and Michael Engelschalk (Senior Public Sector Specialist, Public Sector Management Division, PREM Network) and is partly based on Estela (2000).

If you are interested in similar topics, consider joining the Tax Policy and Administration Thematic Group. Contact Michael Engelschalk (x87764) or click on Thematic Groups on PREMnet.



Poverty Reduction and Economic Management

This note series is intended to summarize good practice and key policy findings on PREM-related topics. The views expressed in these notes are those of the authors and do not necessarily reflect the views of the World Bank. PREMnotes are distributed widely to Bank staff and are also available on the PREM website (<http://prem>). If you are interested in writing a PREMnote, email your idea to Sarah Nedolast. For additional copies of this PREMnote please contact the PREM Advisory Service at x87736.

Prepared for World Bank staff