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International Studies Program
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Reaching a Political Consensus for Tax Reform in Spain: The Moncloa Pacts, Joining the European Union and the Rest of the Journey

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Introduction

After the death of Francisco Franco in November 1975, the political transition was adversely affected by the concurrence of a deep economic crisis and intense social conflict. The hesitant economic policies of the last Francoist and the first transitional governments - up to the 1977 elections - made the economic depression even worse. Therefore, economic imbalances were more serious in Spain than in most other European countries. There were higher levels of inflation, unemployment, balance of payments deficit, public sector deficit and a larger drop in profits and investment.

Two fundamental challenges facing Spain, in the midst of such a serious situation, had to be resolved together. The political challenge called for the transition to be guided towards democracy via peaceful means, while the economic challenge required the economic depression to be lessened and the economic institutions modernised. Both problems required an incomes policy orchestrated by means of a political pact that would permit a constituent process to set up democracy, at the same time several reforms would modernise disfunctional economic institutions. The consensus amongst various political parties made the Moncloa Pacts, signed in 1977, and the Constitution, approved the following year, possible. That exceptional situation led to political and economic agreements unknown in Spain before and after that date. This chapter focuses on the economic pacts that allowed the beginning of tax reform in a democratic setting.

Many factors contributed to the success of the Moncloa Pacts. Firstly, the situation of 'social emergency' created by the economic crisis, the political uncertainty and ongoing social disturbances were decisive. In the midst of such a complicated situation an 'inspection effect' arose that led citizens - and their political representatives - to show altruistic behaviour that benefited the community and permitted a tax increase. The *Unión de Centro Democrático* (Centre Democratic Union, UCD) government managed to reach a national political consensus in 1977-1979. The extreme circumstances that existed led all of the parliamentary parties to sign the Pacts.

Secondly, the Spanish society had become more modern thanks to the economic growth of the two previous decades. A large middle class capable of offering stability to the democratic regime already existed in the 1970s. This middle class was against political adventure, be it revolutionary or totalitarian. Thirdly, within that context of risk of social collapse, the historical memory, especially the memory of the Civil War and the long ensuing dictatorship, weighed heavily. Fourthly, Spanish politicians stated their intention to move towards the economic and political model of the European democracies[1]. In fifth place, a factor that was as fundamental as all of the others was the presence of some economists who were familiar with the European experience and reached an agreement to implement it.

Unfortunately the agreement that was reached for the Moncloa Pacts only lasted until the Spanish Parliament, the *Cortes (formed by the* House of Representatives and the Senate) approved the Constitution in November 1978. Party differences became obvious later on, within the context of the elections in March of 1979. The various UCD governments that followed applied their own economic policies without reaching any kind of general pact. The short-lived period of political consensus prevented the structural economic reforms -including tax reform- from developing according to the plan set out in the Moncloa Pacts and consequently ended up stretching them out in time. In particular, the short life of the Moncloa Pacts frustrated the tax reform as this process would have required a longer lasting consensus. Actually, the tax reform lost support after the 1979 elections. The 'Weak Public Finance of *Unión de Centro Democrático*', harassed by both social and political groups, was not able to either correct the initial defects of the reform, strengthen the Tax Administration, or complete the tax chart that was foreseen.[2] So tax reform had to wait for better times to be completed.

The tax reform of the transition therefore embraced quite an ample period of time. The Moncloa Pacts and joining the European Economic Community were the fundamental axes of the tax reform in democratic Spain. As a matter of fact, the first law passed democratically in the country was precisely the 'Law of Urgent Tax Reform Measures' passed on November 14, 1977. This law got the tax reform process started. The following year was fundamental for the tax reform process as in that year new income tax and corporate tax were introduced. We could say that the tax reform reached its highest point when the Value Added Tax (VAT) became effective on

January 1st, 1986 - the same day that Spain joined the European Economic Community. These are two significant dates because both facts, democracy and integration into Europe, were the corner stones on which the most important tax reform of the 20th century was built.

Actually, before democracy, the tax system that existed in Spain had secular roots as the tax principles had been established in 1845 during the reform carried out by Alejandro Mon[3]. The reforms of 1957 and 1964 carried out by Navarro Rubio, during the Francoist period, respected those tax criteria. By contrast, the Spanish fiscal system changed radically in a relatively brief time between the establishment of democracy and the entrance in the European Economic Community. In that period, Spain managed to incorporate the fiscal principles of the tax model established in Europe after the Second World War.

Given the time delay, the problem that faced the new Spanish fiscal system was that Spain had finally adopted the European tax system at the same time it began to be questioned in the most modern European countries. Therefore, just as it was taking its first steps, the new Spanish fiscal system had to start adapting itself to the new trends in public finance that were spreading throughout Europe. For that reason, the Spanish governments had to make adjustments to the tax system right from the moment when they had completed its full structure with the introduction of the VAT in 1986.

These are the questions that are dealt with in this chapter that is divided into five parts. In the first part, I will study the fiscal legacy the Franco regime left to democratic Spain; its anachronism, injustice and inefficiency was so obvious that no relevant political party opposed the tax reform. This explains, as we will see in the second part, why all of the parliamentary political parties and the social forces approved a tax reform that was based on the principles spread throughout Europe over the previous decades by signing the Moncloa Pacts. In the third part I will analyse the immobilisation of the tax reform process during the period of weak UCD governments that followed the 1979 elections. In the forth part I will examine the culmination of the tax reform proposed in the Moncloa Pacts under the first Socialist governments and the repercussions of joining the European Economic Community bon taxation. Likewise, I will try to explain how the delay and the haste with which these reforms were applied soon lead to criticism of the new tax system, which led the Socialist Party to amend the system as of 1989. Finally, in the fifth part, I will briefly point out the new tax doctrine applied by the Popular Party governments starting in 1996. This doctrine tried to adapt the Spanish fiscal system to new worldwide trends where the competitiveness demanded by globalisation required more efficient taxation.

Origins of the Reform: Criticism of the Anachronistic Tax System of the Period Corresponding to the Franco Regime

The authorities of the Franco regime practised a conservative and anachronistic tax policy, just as the image of the dictatorial regime itself inside a democratic Europe. That policy corresponded to the interests of the social groups that supported the regime and to the economic ideology of the politicians and parliamentarians of the Spanish *Cortes*. Actually, in the first place, the Franco regime always favoured the middle and upper classes through a tax system that exercised a low tax burden and that was clearly regressive. High level civil servants and Ministers of Finance were recruited amongst the privileged classes thereby explaining their reluctant attitude towards tax modernization. The natural exceptions to this attitude were, of course, the corps of technical civil servants.[4] In the second place, between 1957 and 1969, the technocratic ministers linked to the Opus Dei applied a liberal strategy of economic growth centred on companies and private investment which did not prevent the National Industry Institute (*Instituto Nacional de Industria*, INI) from continuing to bail out economically unviable private companies. That strategy pursued the following tax objectives: (a) keep the tax burden low, (b) obtain a balanced budget to avoid issuing Public debt that could crowd out private investment, (c) maintain the stability of prices and currency, (d) grant subsidies to private enterprises through budget expenditures and tax expenditures and also through soft loans financed through the financial repression of individual accounts in banks, and above all, in savings banks, (e) give state owned enterprises a secondary role versus the lead role they had in the industrialising programme during the autarchy (1939-1959), and (f) increase infrastructure and education expenses -public complements essential for stimulating private investment as prescribed in the indicative planning approach of the National Development Plans.

The Flaws of Franco's Tax Reforms.

This last point was crucial because the main goal of the tax reforms of the Franco regime was to obtain sufficient resources to finance public investment. Given the inadequacy of the tax system at the time, the Ministry of Finance headed by Mariano Navarro Rubio put forward the tax reforms of 1957 and 1964. However, the technical limitations of these reforms prevented the Ministry of Finance's tax collection from increasing sufficiently. Therefore, the public investment that was foreseen in the National Development Plans could not totally finance itself. Consequently, at the beginning of the 1970s the deficiencies in public services, the insufficient endowments of infrastructure and human capital were evident and led to a collapse of economic growth. In that situation, as we will see, some Finance Ministers of the Franco regime, (like Monreal Luque and Cabello de Alba), were obliged to sponsor a new tax reform. But in order to obtain a larger tax collection, it would have been necessary to introduce a minimum amount of progressivity into the public finances. The privileged classes of the Franco era attacked the attempts at tax modernisation from this angle and caused their failure[5].

The tax immobility of the Spanish dictatorship concurred with the tax advances in Europe. The Spanish Stabilisation Plan of 1959 put an end to the autarchy and to the regulations that had collapsed economic growth at the end of the 50's but the public sector did not undergo big transformations. Several reforms, especially those of José Larraz (1940) and Mariano Navarro Rubio (1957 and 1964) had changed legislation and created some new taxes[6]. The names, types and ways of managing old taxes also changed. These reforms temporarily increased tax collection but they did not contribute to modernising the principles of fiscal burden sharing in Spain. So, the economic Stabilisation Policy of the late 1950s and the Development Plans of the mid 1960s were implemented without any outstanding improvement in the tax system. The Stabilisation Plan of 1959 was a wasted opportunity, as taxes were not updated. The same thing occurred with the 1964 tax reform, which accompanied the approval of the First Development Plan. This time, again, the system failed to establish a modern income tax or a technically acceptable sales tax, like the VAT.[7]

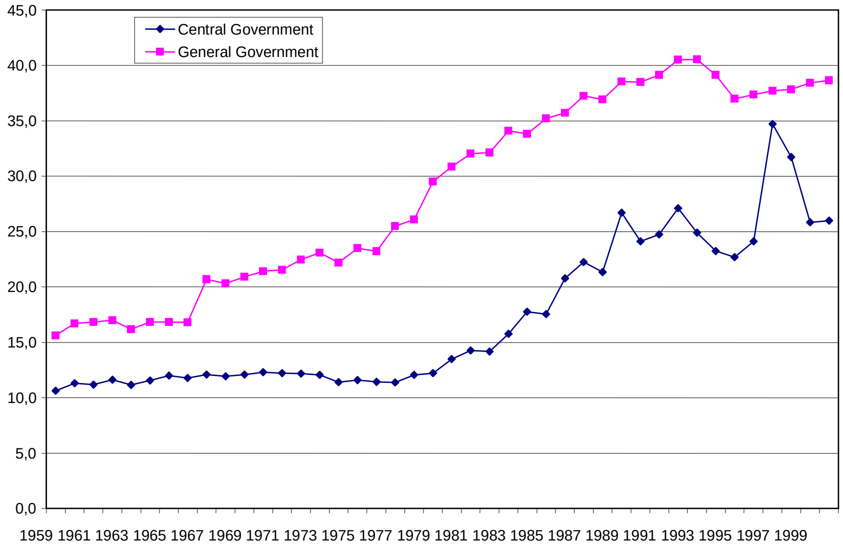
The absence of a modern tax reform during the Franco regime kept a backward, inefficient, insufficient, unjust and not neutral tax system alive. However, its obvious technical defects did not provoke a tax reform because the traditional factors that bring about tax changes in Spain- grave revenue insufficiency, acute inflation and above all, political impetus[8] -had not yet been triggered. The sufficiency of the tax system during the 1960s was an illusion. The Finance Ministers used control budgeting (or budget sequestering) -the expenses were limited to the receipts regardless of the economic and social needs. Franco’s regime preferred to live in budgetary penury rather than carry out a tax reform.[9] The ideological questions were also deciding factors. Despite the proposals of economists and even some Finance Ministers, the sociological and political sectors which supported Franco’s regime never admitted the modern taxation criteria based on the personality of direct taxation and on the generality of indirect taxation. The social groups that enjoyed the favour of the regime also hindered the improvements in tax collection that would have fought against the tax fraud and tax evasion that was commonly admitted and allowed by the Ministry of Finance. The only taxes that were actually collected were those using withholding schemes, such as payroll tax. The figures show that at the beginning of the transition to democracy, tax schedules (the old non-personal or product taxes) still dominated Spanish taxation despite their technical and economic obsolescence. Public finance experts recognised the failure of non-personal taxation but the two Navarro Rubio's reforms were not able to substitute personal taxation for it.

As a consequence, taxpayers only had to endure low tax burdens but, these were unequally distributed.[10] During Franco’s regime the tax burden shows a rather peculiar evolution when compared to European experience. The government of Burgos (Franco established the government of the national army in Burgos during the civil war.) paid the main part of the bill of the Civil War after they had won it[11]. That meant approving some special taxes and fees. This is the reason why the tax burden (defined as the ratio of fiscal revenue to National Income) increased in the post-war period. But once the payment arrears of the war were paid the tax burden receded immediately. Unlike what happened in democratic Europe, Franco’s autarchy did not use the State budget as an instrument of economic policy - neither for financing public works in order to promote economic reconstruction and recovery, nor for funding social spending in order to create the Welfare State. Unlike in Eureopean democracies, the political consensus was not needed in the Spanish dictatorship and public spending did not increase. That's why an increase in tax collection was not needed. . So the tax burden (10.6 percent) in effect during the pre-war period was not recuperated until 1959. In 1969, the fiscal revenue /National Income ratio was still at 12.1 percent[12].

Logically, the tax burden associated with the entire Public Administration (General Government) was greater than the one corresponding to the State (Central Government). (See Graph 1.) But this tax burden also grew moderately during Franco's regime. The immediate reasons were the failure of the Navarro Rubio's first reform in 1957,[13] and mainly that the increase in social insurance contributions during the 1960s after the Bases Law on Social Security that did not go into effect until 1967, although it had been passed in 1963. Nevertheless, the General Government's tax burden did not rise towards levels closer to those in the rest of Europe until the death of General Franco and the beginning of democracy. The ratio of General Government's current revenue to National income grew from 15.6 to 40.5 between 1959 and 1992. This growth took place between 1959 and 1962, in 1967 and especially from 1977 onwards. The consolidation of the Welfare State -that took place as a result of the Moncloa Pacts- demanded more taxes and social insurance contributions to finance its new budgetary functions.

As a result, after 1966, the Central Government' current revenue /General Government ratio decreased due to the boom of the *Seguridad Social* (Spanish equivalent of the British National Insurance or the US Social Security) until 1982.

Graph 1. Tax Burden (1959 – 2000)



Between 1958 and 1966 the Central Government absorbed between 60 percent and 65 percent of the General Government's current revenue while Social insurance collected between 20 and 24 percent. The change came after 1967 when the Central Government's current revenue share decreased to 53 percent and that of the Social insurance grew to 35 percent. The Central Government continued to be the public agent with the largest resources. Ten years later the outlook was different because, in 1978, the current revenue of the social insurance system exceeded that of the Central Government. In 1982 the social insurance collected half of the General Government's current revenue while the Central Government barely retained a third. The decentralisation of the democracy's Public Sector Administration became evident through the rise at the subnational level in the Autonomous Communities' current revenue. Nevertheless, the financing of the autonomous communities (regional governments) suffered from insufficient tax autonomy that made them dependent on transfers and taxes from the Central Government.

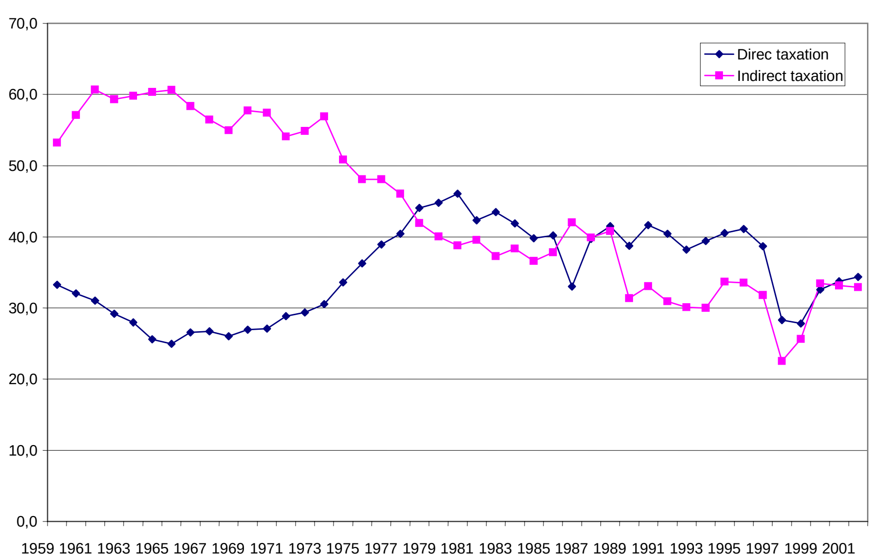
The Backwardness of Spanish Taxation in the Twilight of Franco Regime.

During the final years of Franco's regime the growth of the tax receipts was slowed as much by the regressivity of the tax system -which caused the collection to grow less than the national income- as it was by tax fraud which reduced the effective collections by the Ministry of Finance. The Spanish taxation system continued to be regressive because the average tax rate diminished as the taxpayers' income grew. This regressivity occurred both in indirect taxation and in social insurance contributions. These effects more than offset the moderate nominal progressivity of direct taxation. The implementation of the tax system was even more regressive than its legal configuration. The system became more unjust as tax evasion spread. This was so because evasion tended to be more common in taxes that were, theoretically, somewhat progressive, no matter how reduced they were.

Tax evasion was estimated at 40 percent of tax receipts at the end of the 1970s. The Spanish taxpayers recognised (in 93 percent of those surveyed) the existence of fiscal fraud. The individuals with the greatest ability to pay were left out of the taxpayer roll and there was no political intention to pursue fiscal fraud. The opportunities to commit fraud were not the same -it was calculated to be 70 percent in the upper income level[14]. Wages tax fraud was difficult because the tax was withheld at source. This form of collection procedure was not used for other revenues, not even for corporate tax which was assessed as a presumptive tax. It was obvious that Franco's regime was not interested in stopping fiscal fraud at all as supported by the following facts: (a) fraud was not standardised as a criminal offence, the defaulters only received small administrative sanctions; (b) bank's secrecy on current accounts was sanctioned, (c) there was a ban on publishing taxpayer lists and finally, (d) the Ministers of Finance kept a deficient tax collection system.[15] Deficient tax collection derived from the fact that the tax administration system continued to be poorly endowed with personnel and resources. The number of tax administrators was quite small. At the beginning of the 1970s the number of civil servants in tax administration did not reach a thousand. Probably not only taxpayers, but the Ministry of Finance officers themselves were not interested in increasing their numbers. As a matter of fact, although the 1964 tax reform foresaw the creation of a sub-inspectors corps, pressure from the Tax Inspectors corps succeeded in seeing that there was not one single civil servant in this auxiliary corps by 1975.[16] Besides, inspections lacked co-ordination and there was a special inspection corps for every tax. The lack of administrative control prevented revenue increases because of the widespread fraud. It also allowed abuses in the accounting of tax expenses due to the misrepresentation that companies carried out with impunity thanks to the many exemptions, allowances and bonuses set up in the Development Plans and in the *acciones concertadas* (State agreements with firms). This loss of revenue for the Ministry of Finance was not compensated by an increase in the firms' investments as that type of incentive was not efficient in promoting it[17]

Other features of backward tax systems persisted along with low tax burden during Franco's regime. One of them was the fact that indirect taxes brought in larger revenue collections than direct taxes. Revenues from indirect taxes were as well more variable over time (Graph 2). In addition, the number of indirect taxes was larger than that of the direct taxes and their legislation was not systematic at all. The collection of *Contribucíon de usos y consumos* (Excise tax) fell from 27.7 percent to 18.3 percent of the Central Government's non-financial revenues in 1958 because of the tax reforms of that year. Later on, it fell to 11.9 percent in 1964 as a consequence of the 1959 Stabilisation and Liberalisation Plan.[18] After the liberalisation of foreign trade, the Customs tax replaced excise taxes as the main tax during the 1960s, reaching the ceiling of 21.4 percent in 1966. The 1964 tax reform intensified the decline of excise taxes and collection fell to 7.6 percent of the total tax receipts in 1965 and to 1.6 percent in 1979 (Graph 3). Likewise, from the 1964 reform carried out by Navarro Rubio, the collection of the *Impuesto sobre el Tráfico de Empresas* (ITE, turnover tax) grew. This turnover tax was an obsolete form of cascade tax, brought into Spain at the time when Europe had already introduced the Value Added Tax, which was technically superior.[19] The turnover tax represented 15.2 percent of Central government's receipts in 1974.

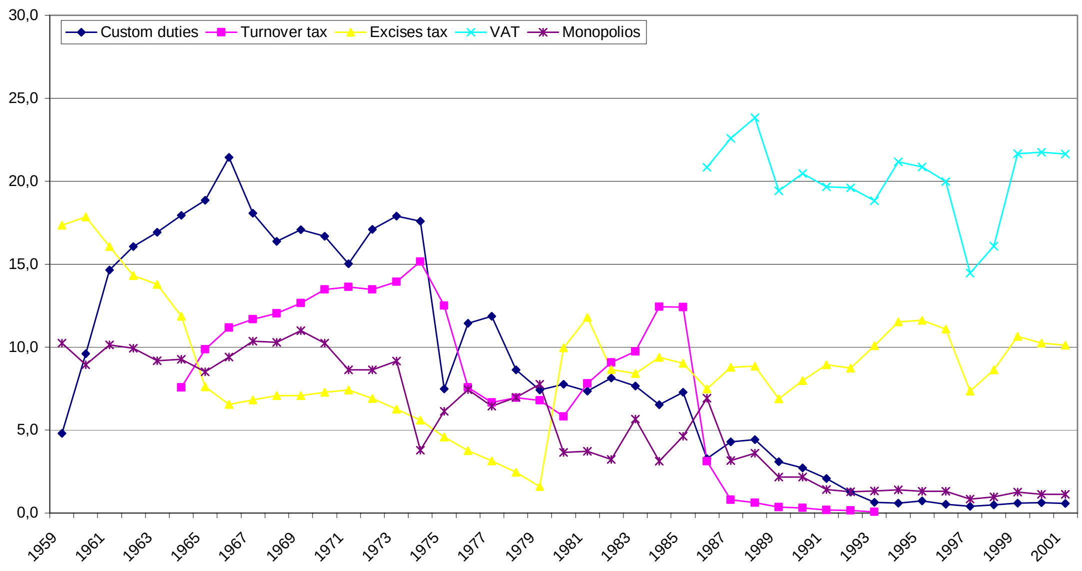
Graph 2. Percentage of Central Government Tax Revenue (1959 – 2001)



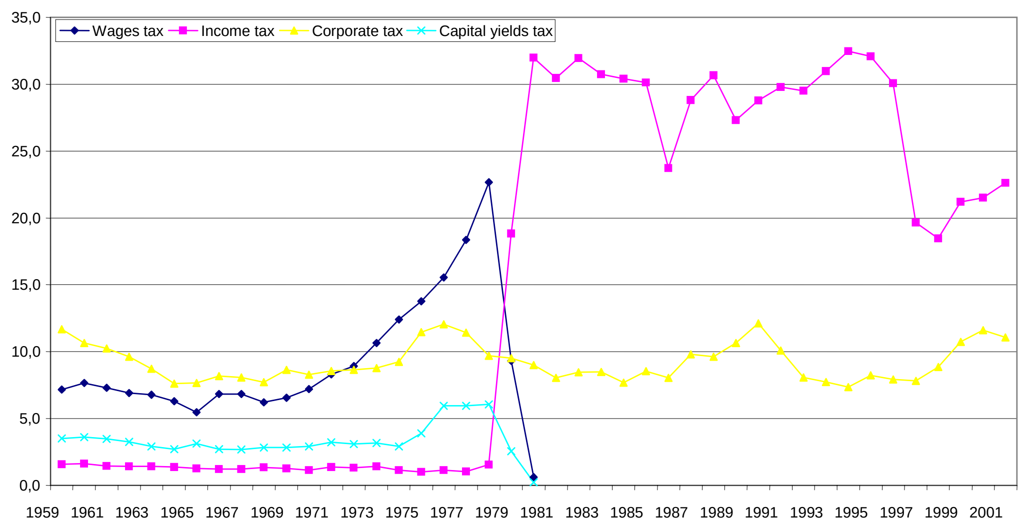
Another fundamental trait of the backwardness of Spanish taxation in this period was the absence of a genuine Income tax. The largest part of the receipts from direct taxation came from tax schedules (the non-personal or product taxes) . From 1964 onwards there were several precursor taxes of the general income tax. The tax levied on salaries stood out. The Wage tax bore a heavier tax burden than the tax on capital income. Before the 1979 tax reform, the wage tax had become the Central

Government's main tax. Its growth during Franco's regime was remarkable. In 1959 Wage tax contributed 7.2 percent of the Central Government's receipts; in 1971 it became the most important direct tax (8.3 percent) and in 1978 it had made up a 22.7 percent share (Graph 4). The receipts from the tax on capital income decreased from 3.5 to 2.9 percent between 1959 and 1974 but later it recuperated to 6.1 percent in 1978. Corporate income tax increased its yield from 5 percent to 10 percent between 1941 and 1953. Later on, it decreased to 7.7 percent in 1965 and after that it recuperated to represent 9.5 percent in 1979. During Franco's regime the Personal Income tax was nothing more than a minuscule, subordinate appendix of product taxation. The percentage of income tax in total receipts still was 1.5 percent in 1978 (Graph 4). The reason for this was its deficient technical definition ever since the *Impuesto complementario sobre la renta* (Surtax) was established in 1932. Along the same lines, the *Impuesto general sobre la renta* (General personal income tax), introduced in 1964, was not a genuine income tax but rather a schedular income tax where the prepayment of tax schedules continued to bring in the largest receipts for the Ministry of Finance. These were a far cry from personal taxation since joint taxpayer incomes were not taken into consideration nor were the tax payers' personal circumstances. The obstacles to implement personal taxation (income tax) in Spain were as much a political factor (Franco's Dictatorship) as a technical tax deficiency of the schedular income tax -the tax that had been chosen by Spanish reformers. Other European countries that tested this type of schedular income tax, such as France and Italy, also underwent similar difficulties in the consolidation of their personal income tax.[20]

Graph 3 Indirect Taxation. Percentage of Central governement's Tax Revenue (1959-2001)



Graph 4. Diirect Taxation. Percentage of Central Government's Tax Revenue (1959 -2001)



Consequently, in the twilight of Franco's regime, old forms of taxation continued to disrupt the development of the national economy. It did not bring in enough resources for the State to provide the public goods and services (basically education, health and infrastructure) demanded by an economy that needed industrialising. Likewise, that tax system, rooted in the 19th century, represented a real risk for social stability because it did not contribute to improving income distribution. On the contrary, this taxation system generated ostensible tax injustices that fed into the existing general social unrest, which Franco's authoritarian rule continued to repress. Besides, from the 1960s onwards, economic growth, more powerful labour unions and a fast urbanization process were changes that were starting to transform the Spanish society. Among other things, social forces were starting to demand policies that would redistribute income. However, this was not feasible with the taxation system in effect because it did not allow for progressivity in the distribution of tax burdens and because the Ministry of Finance's scarce fiscal resources did not allow the supply of merit goods with significant redistribution potential -such as education, health or housing- to grow. The economic crisis that started in the mid 1970s showed, even more, the gap between the Spanish taxation system and the economic and social structures. The rigidity of the taxes hindered any attempt to stabilise the crisis and the revenue inadequacy of the tax system did not allow the budget transfers necessary to alleviate the results of the economic depression.

The Preambles of the Democratic Tax Reform

Given the deficiencies of the traditional taxation system, fiscal economists had been outlining tax reform plans ever since the mid 1960s. As a matter of fact, Public Finance experts were paving the way for reform in different ways. These ways included: criticising the standing tax system and especially the 1964 tax reform, incorporating the European Union's principles of tax harmonisation into their academic values, studying the obstacles that had always interfered with past tax reforms in Spain and by preparing a tax reform project that would be ready when political demand for reform arose. The role of the fiscal economists became institutionalised in 1969 when Enrique Fuentes Quintana was appointed Director of the Institute for Fiscal Studies with César Albiñana as his Assistant Director. The main lines of the reform proposals worked out in the Institute for Fiscal Studies mainly consisted of substituting comprehensive personal taxation for scheduler taxation and Value Added Tax for Excise Duties and Turnover tax. In 1970 the Institute for Fiscal Studies worked hard on the reform and the publication of a double issue of the review *Hacienda Pública Española* in June and July 1970 showed this work. Herein the guidelines of tax harmonisation (that the Neumark Committee was putting to use in the European Economic Community) were used to systematically analyse the necessary changes for taxation in Spain. From the point of view of the Minister of Finance, the matter of tax reform could not still be raised because it was considered politically risky. The Institute could not start the reform project openly so public finance experts decided to collect ideas and experiences from other countries.

In the last years of Franco's regime, policy makers were also very aware of the Spanish taxation system deficiencies. What worried them most was its revenue insufficiency. The technocratic Opus Dei ministers tried to increase the State's revenue to finance the growing infrastructure and education expenses that economic growth policies were demanding, right from the moment they took office in 1957, but even more so after the National Economic Development Plans got started in 1964. However, they came up against political restrictions that vetoed any modern tax reform that implied that in order to collect more revenues the system had to be progressive. Therefore the technocratic ministers could not solve the buried problems of a Ministry of Finance that was apparently healthy. While its budget showed no debt, what was really happening is that the Ministry had given up on fulfilling the purpose of a modern Ministry of Finance. At the beginning of the 1970s the tax system inadequacies were so noticeable that a Minister of Finance of Franco's Government asked the Institute for Fiscal Studies to carry out the preparatory work for the Spanish tax reform.[21] Laureano López Rodó, the Commissioner of the Development Plan, backed the tax reform programme. The reason was that the lack of resources of the Ministry of Finance did not allow the financing of the large public investments foreseen in the development plans. Only genuine tax reform would have allowed the necessary increase in public investment to accompany the big growth in private investment. Those studies were condemned to failure because the agonising Franco's regime opposed fiscal reform just as it would later veto political liberalisation.[22]

As a matter of fact, the first political support for the reform came from Alberto Monreal Luque, the Minister of Finance. In July 1972, the Minister decided that it was time for the Institute to begin working on the tax reform programme. The report was finished in April 1973 which made it possible to hold meetings with the Minister, the technical general secretary, Francisco Fernández Ordoñez and the general directors of the Ministry of Finance. At the beginning of June 1973 the Report, called the 'green paper', was the topic of discussion in the *Comisión Delegada de Asuntos Económicos* (Delegate Commission for Economic Affairs)[23] . This document was even presented to the Head of State, General Franco, and handed out to be discussed in the Cabinet meeting. But, the day after that presentation, Minister Monreal was relieved of his duties. The attempts at tax reform were aborted. His successor in the

Ministry of Finance, Barrera de Irimo did not urge for the reform and any ideas about tax reform were completely forgotten. The assassination of the first President of the Government different from Franco (still the Head of State) since 1938 – Admiral Luis Carrero Blanco- in December of 1973 planted the seed of uneasiness in Franco's regime. The *Caudillo* (one of the names by which General Francisco Franco was known*)* was no longer of sound mind and body and Carrero Blanco had been planned –by some accounts— to be named his successor. Finally, the economic crisis in Europe -brought about by the oil crisis- was starting at this same time. These factors all had some influence on the paralyzation of the tax reform.[24]

Work on the fundamental technique of tax reform continued in the Institute for Fiscal Studies. They also worked on making the various political forces, including the political opposition (semi-clandestine since the beginning of 1976) aware of the need for tax reform but putting it in the framework of both an extensive programme of economic readjustment to face up to the crisis and general economic reform. In this way, when Minister Cabello de Alba tried to urge for the Ministry of Finance's reform programme again in 1976 the team of the Fiscal Studies Institute unenthusiastically started drafting a new report (the 1976 'white paper') with no hope whatsoever of seeing it turned into legislation. Public finance experts at the Institute thought that tax reform was no longer possible unless set in the framework of a programme of far-reaching economic and political reform that would require widespread political agreement to work, something that was not yet possible. Enrique Fuentes Quintana and his team left the Institute for Fiscal Studies because of their differences with the Ministry over the extent of the reform. These incidents all show that tax reform was impossible neither under the regime that Franco and the *Cortes*, elected by organic democracy, had established nor before the democratic general elections. Once the

Dictator had died, the first two transition governments - already under the reign of King Juan Carlos I and presided over by Carlos Arias Navarro and Adolfo Suárez respectively -did not change the tax system. Together with the fact that their energies were concentrated on transforming the political regime, there was another reason consisting of the fact that the reformer economists themselves thought that it was better to wait until there was a parliamentary democracy so that the new tax system could command more legitimacy. To sum up, when the first democratic elections were held in 1977 and Adolfo Suárez formed his second government and Enrique Fuentes Quintana held the Vice Presidency of Economic Affairs the Spanish taxation system had barely changed since Mariano Navarro Rubio's 1964 reform. This fact reveals that the “liberal tax principles” established in 1845 were still in effect.[25]

The Need for the Reform: the Apparent Unaminity in the Moncloa Pacts

The Origins of the Pacts

Therefore tax reform had to wait until the first democratic government. In 1976 the best Spanish economists advocated applying the generalised incomes policy, already in use in the main countries of Western Europe, in Spain. The economic crisis in the continent had provoked social tensions so European politicians were looking for a consensus remedy. The traditional Keynesian policies based on discretionary monetary and tax instruments had not been able to resolve a crisis characterized by the two basic imbalances of inflation and unemployment. In view of the absence of alternatives, practically all of the political parties that competed in the 1978 elections - from *Unión de Centro Democrático* (Union of Democratic Centre, *UCD)* and *Alianza Popular* (Popular Alliance, AP*)* on the right to the *Partido Socialista Obrero Español* (Spanish Socialist Workers' Party, PSOE*)* and the *Partido Comunista* (Communist

Party, PC*)* on the left [26]- included social and incomes policies in their election programmes. *Unión de Centro Democrático* won the general elections in June of 1977. Consequently, the *Cortes* entrusted Adolfo Suárez with the task of forming a government. Enrique Fuentes Quintana was named Vice President of Economic Affairs and Francisco Fernández Ordóñez was named Minister of Finance. These appointments were not fortuitous. Both men had been committed to the prior projects of tax reform. On July 11th the government presented an economic project that included economic adjustment measures (devaluation, monetary restriction, wage control) together with structural reforms in the budget area (taxes and public expenditure) and financial system reforms (liberalisation of financial markets). The first measure adopted by Fuentes Quintana, in this sense, was the July 23rd 1977 Ministerial Order which set up a plan to reduce obligatory investment coefficients of the banks, liberalise some interest rates and increase the rates applicable to special regulation loans.[27]

Economic and tax reforms were more complicated, by nature, than financial market reforms. The negotiations between the Government and the social organisations - employers' associations and unions- had not made progress by August of 1977. So the Government decided to seek and try to reach an agreement among all the political parties represented in Parliament. In September, a team led by Fuentes Quintana developed an Economic Reparation and Reform Programme that convinced Suárez and the rest of the Government of the need to reach a political pact in order to carry it out. In the Moncloa Palace (the office of the Presidency of Government) on October 8th Suárez convinced the political parties to negotiate and to use this programme as a basis. Therefore, when the agreements were signed on October 25th, they were called the Moncloa Pacts. They were later approved by the *Congreso de los Diputados*

(House of Representatives, on October 27th with only one vote against the bill) and by the Senate (on November 11th, with only two abstentions). The incomes policy put into practise, in many ways, was more thorough than the one that was applied in the rest of Europe. Given the institutional delay and the longevity of the Franco dictatorship, the Moncloa Pacts had to include very thorough public sector and market structural reforms, which western democracies had established after World War II.

The Content of the Pacts

The Economic Reparation and Reform Programme contained three objectives. The first one was to correct the basic imbalances of the Spanish economy through a set of preparatory measures already established by the government. The second one was to fairly distribute the costs of the crisis and of economic reparation measures through tax reform, social insurance, and education and housing policies. The third objective was to adapt the Spanish economy to the principles of a market economy through financial and employment policies, industrial relations reforms and modern sector policies referring to agriculture, industry and commerce. The key to success of the Moncloa Pacts was, on the one hand, the subordination of the collective negotiation to price stability and, on the other hand, the use of tax and public expenditure policies as an instrument of income redistribution.

The negotiating strategy of these economic agreements set the principles of dialog between the political parties that led to a consensus for the 1978 Constitution. The Constitution, approved in the *Cortes* on November 17th, defined "a social, constitutional and democratic State subject to the rule of law". In such a way the Welfare State, set up, in fact, in the Moncloa Pacts, was constitutionally consolidated. The main objective of the Pacts was the redistribution of income through progressive taxation and social spending. Nevertheless, the Moncloa Pacts showed temporary asymmetry in their development. The stabilization policies were successful because the immediately relevant instruments could be applied. In contrast, the short-lived consensus did not allow enough time for the structural reforms to be carried out. As a matter of fact, the short-term objectives of the Pacts were reached in 1978 and 1979, when wage stability and inflation control were reached and when corporate benefits were recuperated. Once the Constitution was approved, the consensus was lost and this prevented the structural reforms that had been approved in the Pacts - especially those that referred to creating the Welfare State - from being completed. In exchange for wage control the unions and the left wing parties got concessions in other labour and budget policies in addition to social and political legitimacy.

Three things stand out among the successful ideas of the democratic tax reform: its inspiration in the European taxation system, the approval of urgent measures that paved the way to tax reform itself, and the exploitation of the unique opportunity for consensus that was not only exceptional but very short-lived.[28] Tax reform was incorporated into the global reforms of the Moncloa Pacts and meant the modernisation of the Spanish tax system along European lines where the Neumark Commission had defined the model at the beginning of the 1960s. Its essential principles were: the importance of direct and very progressive taxes, very high marginal rates, notable flexibility and potential tax-collection, and finally, moderate use of indirect taxation.[29]

The main part of the democracy's tax reform strategy was already included in the Institute for Fiscal Studies' 1973 and 1976 reports.[30] It clearly explained the principles as follows: (1) Integration of public spending into the tax reform as a way to justify and rationalise it. (2) A modernisation of the tax administration to prevent the reform from turning into a 'fiscal pipedream' that offered no practical results whatsoever. (3)

Imitation of the tax system operating in Europe -not in vain did Spanish democrats aspire to integrate into the European Economic Community. (4) Institutionalisation of the tax reform through a special organization and a previously fixed calendar to assure fulfilment independent of changes in government. The three first principles were applied in the Moncloa Pacts more or less successfully but the tax reform was not institutionalised, which meant its paralyzation as of 1979. The reform plan prepared by the Institute for Fiscal Studies was incorporated into the Moncloa Pacts especially into the Urgent Measures Law of 1977 and into the 1978 Personal Income Tax and Corporate Income Tax configurations. Nevertheless, only the following measures of the UCD government's anticipated reform projects were approved: (1) Law 50/1977, November 14th which approved the Urgent Measures for Tax Reform; (2) Laws 44 and 61 of 1978 which approved Personal Income Tax and Corporate Income Tax; (3) Law 30/1979 which modified the assessment of the special taxes, and (4) Law 32/1980 which approved the new Tax on Capital Transfers and Documented Legal Proceedings.

The Resistance and Amendments to the Tax Bills.

After the June 1977 elections, democratic change finally created a political mood that was well disposed to the admittance of modern taxation. The previous work explained that at a date as early as July 11th 1977, the Government's programmatic Statement on economic policy could already be made public. Tax reform was an important part of it. Despite Suárez's support, the reformers (led by Fuentes Quintana and Fernández Ordóñez) met up with opposition within the government itself - among the Liberal and Christian Democrat ministers - as well as with the doubts of the *Confederación Española de Organizaciones Empresariales* (CEOE), the Spanish Confederation of Business Associations. This resistance explains the delay in the presentation of the

Urgent Tax Reform Measures Bill until August 9th 1977. The delay to pass the Bill in the Cortes and the Senate was much longer - it wasn't passed until November 14th. This law of urgent measures sought to pave the way for tax reform via the following measures: (a) voluntary regularisation of taxpayers, removal of banker's duty of secrecy, declaration of tax fraud as a crime, and regulation of interposed companies for fiscal transparency; (b) establishment of wealth tax that would serve as a control measure to facilitate establishing and collecting personal income tax; (c) reform of sumptuary tax, and (d) concession of tax allowances to create employment.

To overcome the aforementioned business resistance as well as the left wing parties' resistance to the project, three key alterations were made. They were: (1) a generous tax moratorium was granted, which obviously benefited the previous tax defrauders, but also improved tax compliance after the reform; (2) a regularisation of the accounting of companies was authorised; and (3) progressivity was introduced in the wealth tax[31]. These corrections of the original project fell within Suárez's strategy of using pacts and reaching consensus. They also explained why the 1977 and 1978 tax reforms had barely met with any public criticism or discussion despite the fact that they radically changed the principles of tax burden distribution in Spain - at least in the law. Before 1979 neither the centre nor the right wing parties (*Unión de Centro Democrático* and *Alianza Popular*) nor the business organisations (neither the *Círculo de Empresarios* -Businessmen's Circle- nor the CEOE) objected openly to the tax reform. The explanation is that their amendments to the tax projects were considered by the government while drafting the articles of the laws. Only a few discrepancies were aired publicly with respect to the excessive speed with which the tax reforms were being established and to the rather dubious moment chosen for their establishment given the economic crisis.[32] The lobbying methods and delaying tactics of the right wing groups, in direct contrast with the left wing's haste, slowed down the negotiation of the tax reform.

The Personal Income Tax bill was sent - together with the Inheritance and Wealth Taxes - with considerable delay to the Cortes in January 1978. This delay reveals that beyond general matters, the party confrontations were about particular articles of the law. The ample consensus on tax principles and the left wing's desire to pass the new taxes, as quickly as possible, explain the absence of an in-depth public debate on the reforms. Nevertheless, there was buried opposition to the Government's projects. Due to extra-parliamentary pressures, changes were made to the tax projects before they were publicly debated in the Cortes. These modifications were a more favourable tax treatment of capital returns and gains as well as the annulment of the mechanisms for cross control between the various taxes thereby leaving the door wide open to tax evasion of unearned income. Everything considered, disagreement on tax reform finally became known when some UCD MPs used the Press to show their opposition. The case is that Fuentes Quintana resigned shortly after February 24th 1978. One must look for reasons in the pressures of some business organisations and some leaders of UCD who opposed some of the structural reforms proposed, albeit substantially changed.[33] Bills related to Corporate Tax, Capital Transfers and Documented Legal Proceedings Tax, VAT and Temporary Regulation of Indirect Taxation reached the Cortes even later, in July. Of all these bills, only two were passed. The first was the Personal Income Tax Law passed on September 8th 1978 and the other was the Corporate Tax Law passed on December 27th. This demonstrates that beyond agreements on the general principles, an obvious resistance to the tax reform proposed by the UCD Government existed.

This resistance explains why tax reform in the transition was slightly distorted with respect to the Government's original bills. There are three reasons. First, opportunities for tax fraud and tax avoidance were left in the actual legal texts. Second, the approval of some taxes was delayed, which left the tax system unbalanced. Three, the administrative reform indispensable to put the legal change into effect was not done. Some of these problems also arose out of the haste with which the government wanted to establish the reform contrary to the gradual strategy foreseen in the initial reform plans. The precipitated writing of the tax laws led to formal deficiencies. All of this broke the balance of the reform project, made the later introduction of tax reform more difficult and made it necessary to make various corrections in the legal texts.

Regarding the first point, the 1977 and 1978 tax laws, that were an historic reform in Spanish taxation, suffered from certain technical deficiencies and left some legal gaps. As I already mentioned, that was due to the fact that the consensus of the political parties -regarding the general tax principles- in the Cortes hid a certain resistance to the tax reform. The clearest reflection of this is seen in the amendments that the right wing AP presented. Public opposition was very moderate but there was more decided negotiation to attain certain apparently technical amendments. Those who defended the corrections justified them saying that they were necessary to protect investment and to provide legal safeguard for taxpayers. These amendments had real consequences on the efficiency and equity of the tax laws that were passed. The concessions that the UCD Government made were not so much in the explicit exemptions to payment of tax on certain earnings but rather in the legislative looseness to tax avoidance as well as the blocking of the measures that could help in fighting tax fraud.

The doorways to tax fraud and avoidance were the following. (1) The application of a wealth assessment system to calculate the capital gains that allowed the accumulation of big capital losses when selling assets in the context of a declining stock market. This allowed high incomes to escape income tax payment up until 1985 and even more, many in fact got big refunds back from the Ministry of Finance. (2) Fiscal transparency in income and corporate taxes meant paying less for many well to do families. (3) Corporate accounting regularisation allowed reducing profits for tax effects and therefore smaller payments for corporate tax. And (4) the incorporation of multiple tax exemptions and allowances on investment that led to reducing the taxable base for those taxpayers that were in the upper income brackets.

The pressure exercised on the government by various groups also led to deductions and excessive and arbitrary tax exemptions. Their propagation allowed taxpayers to abuse these tax abatements in view of the absence of efficient fiscal management that generated elevated fiscal expenses. The fight against tax fraud that had been a main objective of the initial plans of the UCD Government was cancelled for a series of reasons. On one hand, the restrictive interpretation of the lifting of the banker's duty of secrecy until 1985 which meant that in practise, this secrecy existed until that year. On the other hand, the development of certain fiscally opaque financial assets became a shelter for dirty money. Finally, wealth tax did not work at controlling taxpayers' income because the parliamentary proceedings excluded the wealth tax on legal persons. Besides, the tax was granted to the autonomous communities which did not develop legal measures so that such a tax could become an instrument of control, as the delay in the update of the cadastre registry reveals. These loophole concessions to tax payment were, without a doubt, related to the fact that the left wing requested that high rates be established for the wealth tax.

Regarding the last points, the problems arose because the tax reform was not institutionalised. By that I mean that the Cortes approved neither a technical commission nor a calendar that would guarantee the implementation of the reform no matter what the political circumstances might be. The absence of this organization hindered the fulfilment of the indirect tax reform (indirect taxation took too long to reform generating an imbalance in the tax system) the modernisation of fiscal administration and the correction of the technical deficiencies of some of the tax laws. Likewise, the implantation of the new taxes was more difficult. In practise, personal income tax was not generally applicable to the entire population of taxpayers because there was no institution in charge of keeping watch over tax fraud. Consequently, tax fraud remained commonplace especially where there were large fortunes or unearned incomes. It was less common in low-income brackets where wage taxes were withheld at source. So, just like in the last years of Franco's regime, salaries were still the basis of direct taxation. Not institutionalising the reform brought about the weakness of the tax management and deficient statistical information that obstructed efficient tax collection.[34] This prevented tax audit from expanding the tax bases (due to their lack of knowledge and consequent fraud). The fiscal insufficiency led the government to raise tax receipts by keeping nominal rates of the personal income tax fixed in the presence of inflation that made taxpayers' nominal income grow. Against all of the initial plans, the reform of public expenditure policy was not adequately integrated into tax reform so the taxpayers noticed degradation of the public spending/paid taxes ratio. Inadequate public expenditure policy together with evidence of tax avoidance and fraud in the high-income brackets made it difficult to legitimise the new taxation system and to increase fiscal pressure on those taxpayers who fulfilled their obligations with the Ministry of Finance. The initial speed and the lack of continuity afterwards in the tax reform created other imperfections such as the deficient handling of international taxation as well as careless use of fees and public pricing as receipts for the Ministry of Finance and as a means to rationalise consumption of public services.[35]

The Tax Counter-Reform of the Weak UCD Governments (1979 - 1983)

After approval of the new Constitution on December 6th 1978, the UCD Government's political reform was postponed, especially regarding tax matters. Clear evidence of this is that the government withdrew from the commitments it had made in the Moncloa Pacts. The reform of indirect taxation was blocked and the same thing happened to the tax management's modernisation projects and to efforts to repress tax fraud. On the contrary, tax advantages to those in the upper income brackets grew. Consequently, the results of the reform in terms of equity, neutrality and efficiency fell far behind what had been foreseen back in 1977. At the same time, advances in public expenditures characteristic to the Welfare State were curbed. Given such a situation, it is not surprising that talk about a tax counter-reform started to emerge. Bringing the reforms to a standstill was a consequence of several factors. These included the departure of Fuentes Quintana from the Government, the March 1979 elections that gave a scant majority to UCD and the internal fragmentation of the centre party itself, the difficulties raised by the reappearance of the economic crisis and the disagreements among the social and business groups, reinforced criticisms of the Welfare State.

The consensus reached in the Moncloa Pacts had already began to fall apart in February 1978 with the departure of Fuentes Quintana from the Government. His was a resignation related to his tax reform proposals, but also to his attempts to restructure the electricity sector.[36] Once the bill creating the Constitution was passed by the Cortes in November 1978, and legalised by the constitutional referendum on December 6th, the political parties ended the consensus and began to compete against each other in the legislative elections that took place in March 1979 after which the period of "Weak UCD Public Finance" began.[37] The party that won the elections, *Unión de Centro Democrático,* did not reach the absolute majority in the Cortes needed to impose the reform. Moreover, the internal confrontations in the aforementioned party lessened the already weak Government. The UCD leaders were not even able to keep the party together. Dissension arose among the various groups that held differing ideological positions within the party. The social democratic faction - that had run the taxation reform - lost power in the very heart of UCD which contributed to its paralyzation. As if this were not enough, the political instability coincided with a worsening of the economic crisis in 1979. This double crisis stopped the economic sector rearrangement and the institutional reforms that both the economy and the Spanish society demanded. The political costs for the UCD Government for continuing with structural reforms grew because differences arose among the social and business groups that, until then, had supported the centre and right wing parties.

In fact, ideological positions of the right wing parties and the business associations shifted. After 1981, the strengthening of *Alianza Popular* and the CEOE secured criticism against the new tax system. These organisations argued that the effects of the reform had been very detrimental to the business because of UCD's excessive left-wing ideas. These opinions fell within the framework of criticism -that arose in the United Kingdom and the United States- of the Welfare State that was spreading throughout Spain starting that year. In Spain, therefore, criticism of the Fiscal State began before there had been time to develop it. The CEOE openly criticised the "enormous growth of public expenditure", which was only true because of the low initial levels and "the demagogic and inadequate tax reform started in 1977". In 1982, this critical opinion of the Welfare State was widespread among businessmen who censured the "fiscal voracity" of the Spanish State. That same year the centrifugal forces that finally divided the *Unión de Centro Democrático* into pieces strengthened the *Alianza Popular* (AP) party, which was politically further to the right. AP ran in the 1982 general elections with an electoral programme that promised "reform of the taxation reform" thereby accepting, as their own, the new taxation speech of the CEOE. The fact that the tax reform agreements of the Moncloa Pacts were only half-completed posed no obstacle to proposing that the new tax system be dismantled. The needs of the Spanish society and the interests of the voters went in another direction, as the results of the elections: The *Partido Socialista Obrero Español* (PSOE) won an absolute majority at the general elections, as we will see.

Consequently, between 1978 and 1982 fiscal legislation barely advanced. The Law of November 30th 1979 suppressed some special taxes such as those on sugar and chicory. It reformed the taxes on alcohol and alcoholic beverages and maintained those on telephone services, the price compensation on industrial alcohols and tobacco growing. The Law of December 25th 1979 on the transitional regulation of indirect taxation corrected some technical aspects of the Turnover and Sumptuary Taxes. Law 21 of June 1980 reformed Capital Transfers and Documented Legal Proceedings Tax. These small reforms left the indirect taxation picture practically the same. As we will see, the implementation of a Value Added Tax (VAT) had to wait until Spain joined the European Economic Community and it was obligated to implement it.

The UCD finance ministers (and also the first PSOE finance ministers) justified keeping Turnover Tax by arguing four reasons: (a) the inflationary effects VAT would have, (b) the losses the disappearance of hidden subsidies of the Turnover Tax would represent for exporters, (c) the complete reform of the tax administration that the implementation would demand, (d) the business organisations' opposition to the VAT, and (e) the strong increase in fiscal pressure that its implementation would mean. The postponement of the indirect taxation reform threw the new taxation system off balance thereby impeding fiscal neutrality, increasing its regressivity, and maintaining widespread tax avoidance and fraud.

The centre party government also stopped normative development of the laws that had already been passed in 1978 and 1979 and, above all, they did not attempt any administrative reforms at all. The result was that the number of people in charge of tax enforcement did not grow. In 1981 the total number of personnel working in the Ministry of Finance was the same as in 1972. Logically, the tax reform could not run adequately with such a lack of civil servants.

The inadequacy of the Administration regarding tax audits demanded by the new taxes was the main reason why taxpayers' tax appeal claims collapsed the *Tribunal Económico Administrativo Central* (Central Economic Administrative Court). Other reasons also contributed to this collapse: (1) the end of global agreements with taxpayers, which meant the demand for individual income tax returns, (2) the increased number of taxpayers especially for the Personal income tax, (3) conflicts that arose from the application of the new taxation regulations and their technical imperfections, (4) lack of available jurisprudence for the Court, and finally (6) deficient legal standardisation of tax fraud and institutional and judicial tolerance. The lack of political decision to fight fraud contributed to the growing tax fraud culture inherited from the Franco's regime.

Some political parties approved the 1977-1979 tax reforms in exchange for some legislative amendments that left wide opportunities for tax avoidance.[38] Later, the change in government permitted a tax counter-reform and paralysed the modernisation process of the tax enforcement apparatus thus allowing some social groups to openly commit tax fraud. This looseness in tax legislation and the Government's negligence regarding fraud conserved social inequality regarding the possibilities of fraud. The tax reform of the transition to democracy period therefore, in practice, hardly changed the incidence of tax burdens in the distribution of income. The Personal income tax carried on as being merely a tax on salaries. Unfairness was strengthened by the persistence of the old indirect taxation until 1985. A transfer of the tax burden from companies to consumers - via indirect taxation - and to the salary earners (who could not commit fraud because their taxes were withheld at source) went along with the growth of fiscal pressure during the transition to democracy. The extent of tax fraud impeded increasing the tax bases "discovered" by the Ministry of Finance. So, to increase public revenue, the governments had to resort to the procedure of not adjusting the income tax rate schedule for inflation, which meant doing something that went against the theoretical principles of the reform planned since 1973. This lack of adjustment for inflation, in practice, meant an increase in the tax burden, but it was logically applied only on the incomes that could not escape taxation -fundamentally salaries.[39]

Culmination of the Tax Reform of the Transition Carried Out by the PSOE and the Subsequent Correction

In 1982 the general or legislative elections gave power to the Socialist party who had promised to complete the tax reforms; and they did. On December 2nd 1982 the first government of the Socialist party (PSOE) was formed with Felipe González as President and Miguel Boyer at the Ministry of Finance. From 1985 to 1993, the Minister of Finance was Carlos Solchaga. This party obtained sufficient political power to enable them to undertake all of the economic reforms that had been postponed since 1979, mainly the industrial reorganisation and the modernisation of the public sector. The comfortable majority that the PSOE obtained in the 1982 general elections allowed the 'reform trail' -that had started in 1977 and that the right-wing[40] political and social powers had opposed- to be retaken.

The First Socialist Tax Reforms.

The first Socialist tax reforms, between 1983 and 1987, completed the tax system that had been programmed in the Moncloa Pacts. The VAT was passed, progressivity was emphasised via the partial reform of Personal Income Tax and the administrative reforms foreseen by the teams led by Fuentes Quintana in the Institute for Fiscal Studies were introduced. This prolongation of the tax reform had two elements. In the first place, from 1983, the PSOE carried out an extensive reorganisation of the tax administration in its various elements: territorial administrations, management was computerised and inspection corps was integrated. In second place, the indirect taxation reform was carried out through Law 30/1985 that introduce the VAT. International pressure was decisive in adopting the VAT, because this tax was an indispensable condition for Spain to enter the European Economic Community. In third place, they set up the instruments to fight tax fraud and to generalise the tax system to the entire population, through the following regulations: Law 10/1985 modifying the General Tax Law, Organic Law 21/1985 reforming the Criminal Code in matters of Crime against the Ministry of Finance, Law 14/1985 regarding the Tax System of certain financial assets, and Law 48/1985 that partially reformed Personal Income Tax. In the fourth place, Law 29/1987 incorporated the new Estate and Gift Tax (or Capital Transfers Tax).[41]

As had happened in Spain in previous historic situations, when the Socialists completed the tax model of the Welfare State, Europe was already consolidating new tax options. On the one hand, the conservative governments of Ronald Reagan in the United States and Margaret Thatcher in the United Kingdom were already using new tax guidelines that were extending to the majority of the member countries of the Organisation for Economic Co-operation and Development (OECD). The objectives of high tax yields and tax progressivity passed to a second line of interest and were replaced by other objectives such as efficiency, reduction of tax rates, expansion of the tax bases and greater prominence of indirect taxation.[42] On the other hand, joining the European Economic Community and globalisation imposed restrictions on the tax treatment of capital that did not exist in 1977. These new taxation trends quickly became part of the Spanish public finance experts' background. Already in 1987 the new, available tax options were published in *Papeles de Economia Española.*[43] Therefore, the public finance experts began proposing new tax reforms that were considered necessary because the tax system, established in the democracy, was full of imperfections that were a result of the historic circumstances in which it had developed. Hence, at the end of the 1980s, Spanish public finance experts began criticising the standing tax system basing their criticisms as much on the new international tax trends as on the deficient practical results of the tax reform of the transition to democracy. It could not be denied that the most obvious defects of traditional taxation inherited from the Franco's regime had been corrected, but it was also evident that some of the old problems persisted and new ones had also appeared. The evaluation that public finance experts made of the reform of the democracy can be summarised in the following points.

The Criticism of the Tax System and the New Reform Proposals.

First, taxation in Franco's Spain was chaotic and outdated. The taxation picture was simplified by the new democratic regime and tax harmonisation with the European Economic Community (EEC) was also reached by introducing modern tax principles such as the personality and progressivity of direct taxation and the neutrality of indirect taxation. Nevertheless, in practice, the delays and imperfections of the reform had penalised direct taxation excessively. Taxes on families (personal income tax and wealth tax) and on businesses (corporate tax and Social Insurance contributions) increased their share in the Central government's receipts. In contrast, consumption taxes had grown less than the balanced taxation system foreseen by the reformers in 1977. Besides, taxes on capital income had stayed in the small percentage points on the tax receipts prior to the reform. The later was the objective sought after by the legislators to link up with European tendencies foreseeing free movement of capital within the EEC. As we have seen, the three main direct taxes introduced by the reform that had started in 1977 were: Personal Income Tax, Corporate Tax and Temporary Wealth Tax that despite the name had become a permanent tax. Personal Income Tax had changed the panorama of tax collection, substituting the old tax schedules (non-personal taxes) that had been introduced in times so far back as 1845 and 1900. After being established, the revenue that Personal Income Tax supplied had grown during the first two years but the collection of Personal Income tax slowed down during the tax counter- reform of 1980-1982. It delayed the technical corrections that public finance experts were demanding until 1983.

The experts had been reporting the notorious flaws of the initial 1978 tax legislation and demanded the modernisation of the tax administration to reduce tax avoidance and to detect the wide tax bases hidden from the Ministry of Finance. As Graph 4 shows, until 1979 no authentic personal income tax existed.[44] That year the collection of Personal Income Tax jumped to 18.8 percent of the Central government's revenue and in 1980 it was already over 32.0 percent, but later its relative growth came to a standstill. In 1985 it was 30.1 percent and logically after setting up Value Added Tax the share of Personal Income Tax revenues in total central fiscal revenue decreased to 23.7 percent in 1986. Afterwards, income tax receipts recovered to a ceiling of 32.5 percent in 1994. The comparative receipts brought in by Corporate Tax after the tax reform (Graph 4) stayed around 8 percent to 10 percent of the Central government's fiscal revenue.[45] The figures show that the tax reform of the political transition to democracy alleviated the tax burden on companies and overloaded the families.[46] The reform of the democracy rested indirect taxation mostly on the VAT -which offered collection capacity advantages and economic neutrality. The VAT receipts represented around the 20 percent of State fiscal revenues since its inception in 1986 (Graph 3). Nevertheless, together with this essential indirect tax of the new system, the tax reformers maintained the traditional excise taxes (on oil and its derivatives, alcohols, beer, wine and tobacco). In fact, some of them only replaced the old fiscal monopolies that were incompatible with European Community membership. These excise duties continued to provide a remarkable 10 percent of public revenues (Graph 3). The indirect taxation harmonisation with EEC also implied raising the rates of these excise taxes which previously were lower in Spain than in the rest of Europe. Consequently, around 1990, the Spanish tax structure was much closer to Europe's: direct tax on personal income and corporate profits collected 29.6 percent, social insurance contributions brought in 36.2 percent and VAT and the excise duties brought in 29.3 percent. Therefore, 95.1 percent of the public revenue at the beginning of the 1990's was based on these three basic pillars, achieving the tax simplification objective pursued all along by the democratic tax reform.

Secondly, tax management had been perfected but moderately and insufficiently. That's why, although there was less tax fraud compared to times of Franco's regime, there were still some professional and economic sectors where widespread fraud persisted. This is where the principal problem in implementing the reform was located given the permissiveness of the UCD governments in the fight against tax fraud. In 1980 there was a big improvement in the number of taxpayers who met their obligations and filed their Personal Income Tax returns. Over the following two years the number of new taxpayers barely grew and the differences between earned income and declared income hardly improved. After 1983, especially in 1985 and 1986, the fight against tax fraud intensified,[47] and noticeably improved the levels of compliance. The tax administration's efforts to control the so called 'other earnings' with the help of VAT were noticeable. The Commission for Tax Fraud Evaluation's estimates revealed widespread tax evasion in almost all taxes. In 1985 the percentage of incomes declared to the Ministry of Finance with respect to the incomes that should have been declared in Personal Income Tax, estimated from macroeconomic variables, was 44.9 percent. Half of the Spanish people's income did not pay this tax. On the other hand, in 1986, 27 percent of the workers did not contribute to the *Seguridad Social.*[48] Finally, in VAT, fraud was around 28 percent of the collection in

1986 but if we exclude imports that were very controlled by Customs, the level of fraud raised to 39 percent.[49] This widespread fraud reduced the theoretical advantages of the tax system of the democratic regime regarding equity. In principle, the larger revenue yield from the Personal Income and Wealth taxes after 1977 revealed a fairer distribution of the tax burden in relation to the one that was in effect during Franco's regime. In fact, widespread tax fraud was still the main problem of Spanish taxation at the end of 1980's. Because it was applied on the taxpayers unfairly due to the asymmetry of tax fraud, the high tax rates worsened the distortions and the defects of the existing taxation.[50]

Nevertheless, despite the high index of fraud in some sectors, social acceptance of the income tax had improved with democracy in Spain. The radical reform of the Personal income tax in 1978 implied a change in the levels of tax compliance and in the number of tax returns filed to the Ministry of Finance. But with time, at the end of the 1980s some tax resistance reappeared demanding a lesser tax burden, especially because the citizens thought they were getting fewer public services than the sacrifices they made by paying taxes. They also appeared to have thought that the State Administration squandered the public resources it had.[51].

Thirdly, the criticisms of the tax system that was implemented since 1977 were general a decade later. Public finance experts argued that the system had not met the basic principles of the tax reform package because: (a) it was not revenue sufficient in any year, (b) it was not equitable, neither horizontally nor vertically, (c) it was not easy for the taxpayers to fulfil his/her obligations or for the Administration to collect, and (d) it was not neutral with respect to economic activity because it had distorted the allocation of resources. The critics emphasised that the increased tax burden had not even worked to achieve sufficiency, given the larger growth of public expenses.

The rapid growth of tax receipts was as much due to the tax reform as it was to mere growth of the nominal incomes of taxpayers, as I remarked above, the Personal Income Tax rates had not been corrected for inflation. The insufficiency obliged the Ministry of Finance to resort to borrowing from the central bank, the Bank of Spain, setting up the inflationary tax through 'seignorage'. It was estimated that the public revenue from seignorage grew between 1980 and 1990 to reach a yield of nearly 1.7 percent of the Gross Domestic Product (GDP).[52] As we have already seen, the distribution of the tax burden by rent groups and by economic sectors was considerably unfair given the generalised tax fraud. On the other hand the excessive complexity of the Personal Income Tax provoked rejection of the tax by the taxpayers, continued pressure by the taxpayers to obtain more tax abatements and special tax treatments, and high compliance costs for taxpayers and for the Tax Administration.[53] Likewise, the odd creeping up of the effective marginal rates and the proliferation of allowances did not allow an adjusted system of Personal Income Tax withholding to appear, which made it difficult to spread this tax.[54] Finally, the disincentives that high marginal rates of Personal Income Tax usually produce on the supply of the factors of production and the consequences of the excessive proliferation of deductions on the efficiency of the economy also made their presence felt. At the beginning of the 1990s the high IRPF rates and the complexity of its rate schedule hindered the achievement of the goals of simplicity and efficiency. Likewise, public finance experts already foresaw that the internationalisation of taxation would end up making Spain adjust its tax treatment of savings to that of the EEC countries to prevent savings from leaving the country.[55]

In fourth place, there were other critical considerations of the tax system that needed to be addressed. In the case of the corporate income tax, one criticism was, at the beginning of the 1990s, that burdens were higher (by 40 percent) than those in effect in the EEC with values near 12 percent. This was explained by the higher weight of employers' social security contributions .in Spain. It was also argued that the corporate income tax and the personal income tax should be better integrated to avoid the double taxation of dividends. Some public finance experts recommended that social insurance contributions should be replaced by indirect taxes (a VAT increase) because of its favourable effect on foreign trade.

An interesting proposal that dates back to 1987 was the flat tax, characterized by a single tax rate and no deductions or exemptions except for minimum level of personal income to provide the tax with the desired degree of progressivity. It was argued that the flat tax promised to improve simplicity, efficiency and equity - three objectives sought after by taxation versus the problems really raised by Personal Income Tax in effect in Spain with too many tax rate brackets and too many allowances.[56] As always happens with the most radical tax proposals, the political parties only defended the flat tax while they were in the opposition.

The Socialist Governments' Amendments to the Tax Reform.

All this criticism of the tax system established as of 1978 led to some guidelines to correct the reform, some of them were implemented by the Socialist governments themselves. At the end of the 1980s there were two tax changes that were imposed on the Ministry of Finance: 1) the February 20th 1989 ruling of the Constitutional Court forced a reform of Personal Income Tax and Wealth Tax and Legacy Duty ; 2) the European Market forced tax harmonisation, essentially in taxation of capital yields to prevent it from flying to other countries.

As a matter of fact, one of the first proposed amendments referred to the concept of the taxpayer. The 1978 reform had identified family as a taxable unit but the

Constitutional Court declared the obligatory joint tax returns unconstitutional in February 1989. A transitory regime was established for the years 1988 and 1989 and extended to 1990 in order to adapt the tax to this court ruling. This allowed the taxpayers to choose among separate and joint returns depending on which of the two was most beneficial. It also established that investment yields could be divided between the spouses while salaries could not. Later Laws 18 and 19/1991 definitively adapted the personal income tax and wealth tax to ruling 45/1989 of the Constitutional Court on taxation of the family unit.

In mid 1989 the authorities of the Ministry of Economy and Finance were very clear on the taxation objectives but they could not always put their intentions into practise. The Ministry publicly undertook a campaign to spread the need for the reform of the personal income tax. The proposed guidelines were as follows: (1) reduce the direct tax burden and increase the indirect tax burden (VAT), (2) obey the Constitutional Court ruling to not discriminate families but to maintain progressive formulas, (3) promote family savings but not only by reducing direct taxes, (4) discourage home buying, (5) make dirty money surface but without offering a tax amnesty; (6) reduce public spending and the budget deficit while continuing to invest in infrastructure, (7) reform the presumptive assessment of VAT for shop owners and independent professionals to reduce fraud, and (8) progressively reduce the withholdings on investment yields to take Spanish regulations closer to those of the EEC.[57]

On the other hand, in 1990, the Ministry of Finance considered that, although the Spanish public sector was inferior in size to those of the other European countries, they had to stop its growth in the future for the following reasons: (1) the inconvenience of increasing individual tax burden, which would reduce private savings -already quite deteriorated, and (2) macroeconomic stabilisation objectives did not allow the public spending to GDP ratio to increase further. The objective here was to eliminate the public deficit in 1992 by increasing revenue, intensifying the fight against fraud and perfecting tax management without increasing the tax burden of those who honestly met their obligations to the Ministry of Finance.[58] The increase in budget revenue would have to come from increasing the assessment bases, from economic growth and from the fight against tax fraud.

The Royal Decree Law of December 29, 1989 on urgent measures in Budget matters (replaced in its entirety by Law 29 of June 1990) contained the core of the measures on taxation for 1990, intended to annually adjust the taxes to the new economic and social reality. The 1990 Budget asked the authorities in charge of tax policy to prepare a tax reform under the following guidelines: approximation to the tax systems of the EEC countries, search for indirect tax harmonisation, increasing the VAT and Special tax rates and reduce the tax burden from the Personal Income tax.[59]

The Rest of the Journey: The 'Ppopular' Government's New Taxation Concept

The delay in introducing the tax reforms implied, yet again, that the Spanish tax system of the democratic regime went in the wrong direction when compared to the new trends in more economically advanced countries[60] The question that should be introduced is whether, in the field of tax reforms, it is possible for a country to skip stages. The Spanish case demonstrates that it is only possible to make rapid progress through them. The tax reforms of the UCD and PSOE governments were inevitable because they imitated a tax model that was already consolidated in Europe and that was also really the only one available in 1977 when the reform was carried out in Spain. The governments of the transition could not run any risks with tax experiments. The establishment of democracy in Spain could not avoid the fulfilment of the "demonstration effect" that the Welfare State developed in Europe between 1942 and 1980 had on Spain during the dictatorship and the transition. What they could not have done was to try to skip stages by adopting some of the proposals of the new taxation models before consolidating the one established as of 1977. Criticisms from the right wing politicians and businessmen came before the taxation system of the democracy was consolidated. The Welfare State had still not been developed in Spain, and they were already criticising the 'excessive' tax burden imposed by the public sector.

The criticisms of the tax system of the democracy from academia came at the end of the 1980s after the new tax model had been spread throughout most OECD countries and when the problems of the taxation system established in Spain were very evident, given the new international experiences. The Socialist governments themselves raised some of the corrections and proposed innovation at the end of the 1980s. Consequently, the golden age of the Welfare State, that had lasted four decades in Europe, lasted only one decade in Spain. In 1995 the contrast between the tax system of the OECD member countries and the Spanish one were very marked. Spain continued to be anchored in the model that had been established in Europe in the post-war period: high marginal rates, tax schedules with many income brackets, narrow tax bases, high Personal Income Tax share and low VAT share in the structure of public revenues, and high importance of social insurance contributions. In the mid 1990s the tax burden supported by the majority of the taxpayers who did not commit fraud could already be termed overwhelming. The political reaction of right wing parties was to offer voters tax reductions and this was very likely one of the reasons for the victory of the *Partido Popular* (PP) in the 1996 elections.

Therefore, some of the new proposals of the public finance experts were introduced only after 1996, by the Popular Party government led by José María Aznar, with Rodrigo Rato and Cristóbal Montoro in the Ministry of Finance. The PP's arrival to government in Spain almost coincided with the Stability and Growth Pact, outlined in the European Summit in Dublin in December 1996 although it wasn't formalised until June of 1999. The budget orthodoxy followed by the Spanish government allowed a noticeable reduction of the budget deficit and of the outstanding public debt. The restrictions on fiscal policy imposed by the Stability Pact were reinforced by the economic globalisation that demanded the search for efficiency in the Spanish economy. All of this, within the tax reform framework, meant accepting the principle of efficiency in the allocation of resources as the fundamental one, since the PP government had assumed the limitations of very formal progressive taxes as a means of income redistribution. Therefore, the gradual tax reform was imposed in 1996 with the objective of reducing the tax rates to foster economic growth and employment, to stimulate savings, to strengthen small and medium sized firms and to help internationalise Spanish corporations. The main measures implemented by the first PP government were: (a) in 1996 capital gains tax rates were reduced[61], (b) in 1998 a new tax regime for small and medium sized companies was passed, and (c) in the same year the Taxpayer's Statute *(Estatuto del Contribuyente,* Law 1/1988) was passed. Once the Maastricht objectives were met and Spain joined the European Monetary Union, the PP government went on to reform Personal Income Tax via Law 40/1988 to incorporate new international trends in the Personal Income Tax including the following: tax burden reduction especially on low incomes and salaries, decrease in marginal tax rates to avoid its negative consequences on savings, labour supply and investment, encouragement of long term savings, tax protection for families and simplification in the tax return forms for many taxpayers. The reduction of the tax burden in Personal Income Tax (10 percent of disposable personal income) allowed an increase in tax receipts (4 percent) in 1999 versus 1998. It also had the expected improvements in the distribution of tax burdens and the reductions in taxpayer compliance costs.

The next reform of the Personal Income Tax in Law 6/2000 tried again to promote the internationalisation of Spanish companies, to facilitate the adoption of new technologies strengthening of small and medium size enterprises, to protect the family unit and the most disfavoured social classes, and to encourage long-term savings. The 2002 *Ley de Acompañamiento a los Presupuestos Generales del Estado* (the Law accompanying the State's General Budget) introduced a new tax reform in the direction indicated by the Commission for Personal Income Tax Reform created in January 2002, chaired by Manuel Lagares. The objectives of the reform this time were to improve the tax treatment of the families and the disabled, reduce taxation on the lowest salaried incomes, improve the stability and mobility of employment, stimulate the supply of rental homes, improve neutrality in savings products and favour retirement savings, reduce tax rates (with a maximum rate of 45 percent) and the number of brackets (to five) safeguarding the principles of progressivity and sufficiency, and rearrange the taxation of professionals. The PP Government reformed the corporate tax.[62].

The results of the Popular Party’s tax reforms can be evaluated on the basis of collection figures. The general Government’s tax burden peaked in 1992 at 40.5 percent. It stagnated the following year, falling to 37.0 percent in 1995. As of 1996, the general tax burden recovered and reached 38.6 percent in 2000. For its own part, the central government’s tax burden grew from 22.7 percent to 26 percent from 1995 to 2000 (Graph 1). From 1995 to 2001, the share of the central Government's direct taxes fell from 41.1 percent to 34.4 percent, while indirect taxes only decreased from 33.5 percent to 32.9 percent over this time. As such, during the Popular Party Administrations, revenues generated by direct and indirect taxes were about the same (Graph 2). The collection of income tax reached its peak with respect to total public revenues at 32.5 percent in 1994. In 1996, this percentage was at 30.1 percent, but in 2001, income tax accounted for only 22.6 percent of the central government's total tax revenues. To the contrary, the corporate tax increased from 7.3 percent to 11.1 percent from 1994 to 2001 (Graph 4). Excise taxes were 11.1 percent in 1996, and declined to 10.1 percent in 2001, while value-added tax increased from 20 percent to 21.6 percent over this time. Consequently, the most remarkable feature of this period was the decrease of the relative collection of income tax and the increase of receipts generated by other indirect taxes, which still allowed for an increase of the tax burdens.

Conclusions

The Spanish case clearly shows the relevance of political factors in the evolution of its tax systems. The Franco Dictatorship posed an insurmountable obstacle to tax modernization in Spain. That created a lag in the establishment of modern taxation emerging across Europe after the Second World War. Despite sharp economic growth from 1960 to 1973 and the projects presented by the Treasury and the Ministerio de Planes de Desarrollo (Ministry for Economic Plans), Spain could not approach the European taxation norm, which included two basic taxes: progressive personal income tax and value-added tax. When the tax reform of 1977 was undertaken after the democratic elections, the taxation principles established in 1845 by the liberal State were still in effect in Spain.

In Spain, one had to wait for democracy to create a series of economic reforms. Most noteworthy among these changes were the modernization of the public sector via tax reform and increased spending by the welfare state, and the liberalization of markets (foreign, financial and labor). The end of the Franco regime also allowed Spain to enter the European Economic Community. That entailed the introduction of value-added tax, completing the tax reform that brought the Spanish tax system closer to the European model. The taxation principles adopted by Spain between 1977 and 1986 were similar to those adopted by Europe after the Second World War. By 1986, the main taxes in effect in Europe had been established in Spain.

However, some of the European taxes that Spain copied were being reformed in Europe. Furthermore, the legal definition of the Spanish taxes and their administration presented problems that needed attention at the end of the 1980s. That required the creation of new tax reforms that updated the taxes introduced between 1977 and 1986. Although these new reforms were important, they did not include new taxes or changes in the taxation criteria. Instead, all that was changed were the technical characteristics of the taxes established during the transition to democracy.

As had occurred in the reform of 1845, which established the taxation of the liberal State, the reform begun in 1977 entailed such a radical change in the taxation principles that it required political consensus for its approval. The magnitude of the changes and the need to cater to conflicting social interests in order to achieve the consensus resulted in a reform with flaws which later had to be corrected. Moreover, once the consensus was finalized and the reform went through, the subsequent governments first paralyzed and afterwards accelerated the implementation and generalization of the new taxes and even changed some technical points.

As such, tax reform in Spain did not take place overnight, once and for all, but was rather the result of several reformatory impulses pursued by different governments. Because of this, the tax reform under the democracy needed more time to be established and consolidated, and to adapt gradually to the permanent international advances in taxation. Sure enough, a decade after the reform of 1977 started, new international trends in the composition of direct taxes were spreading, both within the framework of globalization and out of the necessary improvement in the productivity of national economies. Additionally, the reforms of the taxes established as of 1977 also required adjustments in the different taxes due to the changes of government. However, these tax modifications were not so extensive, given the restrictions imposed by Spain’s membership in the European Union and the growing international movement of capital.

Index table

Table 1. Public Revenue/PIB (1959 -2000)

	Central Government	**General Government**
1959	10.6	15.6
1960	11.3	16.7
1961	11.2	16.8
1962	11.6	17.0
1963	11.1	16.2
1964	11.6	16.8
1965	12.0	16.8
1966	11.8	16.8
1967	12.1	20.7
1968	11.9	20.3
1996	12.1	20.9
1970	12.3	21.4
1971	12.2	21.5
1972	12.2	22.5
1973	12.1	23.1
1974	11.4	22.2
1975	11.6	23.5
1976	11.4	23.2
1977	11.4	25.5
1978	12.0	26.1
1979	12.2	29.5
1980	13.5	30.8
1981	14.3	32.0
1982	14.2	32.1
1983	15.8	34.1
1984	17.8	33.8
1985	17.6	35.2
1986	20.8	35.7
1987	22.2	37.2
1988	21.4	36.9
1989	26.7	38.5
1990	24.1	38.5
1991	24.8	39.1
1992	27.1	40.5
1993	24.9	40.5
1994	23.2	39.2
1995	22.7	37.0
1996	24.1	37.4
1997	34.7	37.7
1998	31.7	37.8
1999	25.8	38.4
2000	26.0	38.6

Source: Comín and Díaz (2004) and Pardos de la Excosura (2003)

Table 2. Percentage of Central Government's Revenue (1959 -2001)

	Direct Taxation	**Indirect Taxation**
1959	33.3	53.2
1960	32.1	57.1
1961	31.0	60.7
1962	29.2	59.3
1963	28.0	59.8
1964	25.6	60.3
1965	25.0	60.6
1966	26.6	58.4
1967	26.7	56.5
1968	26.0	55.0
1996	27.0	57.7
1970	27.1	57.5
1971	28.9	54.1
1972	29.4	54.9
1973	30.6	56.9
1974	33.6	50.8
1975	36.2	48.1
1976	38.9	48.1
1977	40.4	46.1
1978	44.1	41.9
1979	44.8	40.0
1980	46.0	38.8
1981	12.3	39.6
1982	43.5	37.3
1983	41.9	38.4
1984	39.8	36.6
1985	40.2	37.8
1986	33.0	42.0
1987	39.7	39.9
1988	41.5	40.8
1989	38.7	31.4
1990	41.7	33.1
1991	40.4	30.9
1992	38.2	30.1
1993	39.4	30.0
1994	40.5	33.7
1995	41.1	33.5
1996	38.7	31.8
1997	28.3	22.5
1998	27.8	25.6
1999	32.6	33.4
2000	33.7	33.1
2001	34.4	32.9

Source: Comín and Díaz (2004)

Table3. Indirect Taxation. Percentage of Central Government's Revenue (1959 -2001)

	Custom Duties	**Turnover Tax**	**Excises Tax**	**VAT**	**Monopolios**
1959	4.8	-	17.4	-	10.2
1960	9.6	-	17.9	-	8.9
1961	14.6	-	16.1	-	10.1
1962	16.1	-	14.3	-	9.9
1963	16.9	-	13.8	-	9.2
1964	17.9	7.6	11.9	-	9.3
1965	18.8	9.9	7.6	-	8.5
1966	21.4	11.2	6.6	-	9.4
1967	18.1	11.7	6.8	-	10.3
1968	16.4	12.0	7.1	-	10.3
1996	17.1	12.7	7.1	-	11.0
1970	16.7	13.5	7.3	-	10.2
1971	15.0	13.6	7.4	-	8.6
1972	17.1	13.5	6.9	-	8.6
1973	17.9	13.9	6.3	-	9.2
1974	17.6	15.2	5.6	-	3.8
1975	7.5	12.5	4.6	-	6.1
1976	11.4	7.6	3.8	-	7.4
1977	11.9	6.7	3.1	-	6.4
1978	8.6	6.9	2.5	-	7.0
1979	7.4	6.8	1.6	-	7.8
1980	7.8	5.8	10.0	-	3.7
1981	7.3	7.8	11.8	-	3.7
1982	8.2	9.1	8.6	-	3.2
1983	7.7	9.7	8.4	-	5.7
1984	6.5	12.4	9.4	-	3.1
1985	7.3	12.4	9.0	-	4.6
1986	3.3	3.1	7.5	20.8	6.9
1987	4.3	0.8	8.8	22.6	3.2
1988	4.4	0.6	8.9	23.8	3.6
1989	3.1	0.4	6.9	19.4	2.2
1990	2.7	0.3	8.0	20.5	2.2
1991	2.1	0.2	8.9	19.7	1.4
1992	1.3	0.2	8.7	19.6	1.3
1993	0.6	0.1	10.1	18.8	1.3
1994	0.6	-	11.5	21.2	1.4
1995	0.7	-	11.3	20.9	1.3
1996	0.5	-	11.1	20.0	1.3
1997	0.4	-	7.4	14.5	0.8
1998	0.5	-	8.6	16.1	1.0
1999	0.6	-	10.6	21.7	1.3
2000	0.6	-	10.2	21.7	1.1
2001	0.6	-	10.1	21.6	1.1

Source: Comín and Díaz (2004)

*Table 4. D*irect Taxation. Percentage of Central Government's Revenue (1959 -2001)

	Wages Tax	Income Tax	Corporate Tax	Capital Yields Tax
1959	7.2	1.6	11.7	3.5
1960	7.7	1.6	10.7	3.6
1961	7.3	1.4	10.2	3.5
1962	6.9	1.4	9.6	3.3
1963	6.8	1.4	8.7	2.9
1964	6.3	1.4	7.6	2.7
1965	5.5	1.3	7.7	3.1
1966	6.8	1.2	8.2	2.7
1967	6.8	1.2	8.1	2.7
1968	6.2	1.3	7.7	2.8
1996	6.5	1.3	8.6	2.8
1970	7.2	1.1	8.3	2.9
1971	8.3	1.4	8.6	3.2
1972	8.9	1.3	8.6	3.1
1973	10.6	1.4	8.8	3.2
1974	12.4	1.1	9.2	2.9
1975	13.8	1.0	11.5	3.9
1976	15.6	1.1	12.0	6.0
1977	18.4	1.0	11.4	6.0
1978	22.7	1.5	9.7	6.1
1979	9.3	18.8	9.5	2.6
1980	0.6	32.0	9.0	0.2
1981	-	30.5	8.0	-
1982	-	31.9	8.5	-
1983	-	30.8	8.5	-
1984	-	30.4	7.7	-
1985	-	30.1	8.5	-
1986	-	23.7	8.0	-
1987	-	28.8	9.8	-
1988	-	30.7	9.6	-
1989	-	27.3	10.7	-
1990	-	28.8	12.1	-
1991	-	29.8	10.1	-
1992	-	29.5	8.1	-
1993	-	31.0	7.7	-
1994	-	32.5	7.3	-
1995	-	32.1	8.2	-
1996	-	30.1	7.9	-
1997	-	19.6	7.8	-
1998	-	18.5	8.8	-
1999	-	21.2	10.7	-
2000	-	21.5	11.6	-
2001	-	22.6	11.1	-

Source: Comín and Díaz (2004)

Notes

1. In the end, what they did in 1977 and 1978 was very similar to what the European democracies had managed to do after the Second World War. They set up a democratic system and created a consensus for the creation of a Welfare State as well as the development of fiscal, monetary and tax policies that would contribute to political, economic and social stability. The political parties tried to imitate the European model but without specifying the characteristics of the model. The generalities of this objective permitted them to reach a political consensus that would have been impossible if they had not avoided the obvious differences that existed among the various European States.
2. This was at least the opinion of Fuentes Quintana (1983 y 1990a), who will become later the chief architect of the tax reform.
3. See Comín and Vallejo (2002).
4. See Gunther (1980, pp. 64 -67)
5. See Fuentes Quintana (1978 and 1990a) and Comín, Martínez, Martorell and Vallejo (2005).
6. See Fuentes Quintana (1997) and Fernández Clemente (1997).
7. Fuentes Quintana (1961) and Comín (1991).
8. See Fuentes Quintana (1964), Albiñana (1974), Albiñana and Fuentes Quintana (1966).
9. See Gunther (1980).
10. Following Fuentes Quintana (1991). See Valle (1974) and Lagares (1975).
11. See Comín y López (2002).
12. See Comín (1996a, pp. 156-162) and Comín (1996b, pp. 43-47).
13. Minister Rubio refused to switch tax collection procedures from the “collective taxpayer agreements” to individual filings; this practically brought collections to a halt.
14. See Fuentes Quintana (1983), Comisión para la Evaluación del Fraude (1986), Comín (1991) and Lagares (1991).
15. See Biescas (1980. pp 116 -123).
16. Gunther (1980, p. 95)
17. Fuentes Quintana (1973 and 1978) and Comín (1996b).
18. The excise tax came out of Larraz's reform and had brought between 18percent and 28percent of the ordinary income of the State between 1941 and 1960; during the autarchy (1939-1959) foreign trade was subject to contingent regime which reduced customs receipts to 4percent to 6percent.
19. As Fuentes Quintana (1964) already pointed out the same year.
20. See the references to the Latin tax system in Fuentes Quintana (1991) and Comín (1996a, pp. 205-224).
21. See the excellent description of the entire process that lead to the creation of the tax reform programme in Lagares (2002, pp. 586-600).
22. In the reports prepared by the team led by Enrique Fuentes Quintana (1973 and 1976), a reform plan was presented that implied getting rid of taxes in effect in Spain from the 1845 reform and it highlighted the previous requirements needed to establish the tax reforms in Spain. These reports were the basis of the reform that was started in 1977. Enrique Fuentes Quintana - who had studied the work of Ramón Santillán and Antonio Flores de Lemus - played a key role in the tax reform that started in 1977 similar to the public finance experts carried out in the 1845 reform and the one that was programmed between 1910 and 1932.
23. The members of this commission were the “subsecretarios” (deputy secretaries) of the economic ministries. The commission met before the weekly Cabinet meeting presided by Franco himself in order to discuss and prepare the issues and bills to be approved by the Government.
24. The mere existence of the 'green paper' supposed such a threat to the Franco regime that the government made the document secret. For these matters see Valiño (1989) and Pan-Montojo (1996, pp. 267 - 299) and Lagares' evidence (2002, pp. 586-600). See also Fuentes Quintana (2004).
25. See Pan-Montojo (1996 pp. 266-275). In 1977, Spain and Portugal were the only Western countries that still did not have a real personal income tax. See Comín (1991) and Fuentes Quintana (1991).
26. See Pan-Montojo (2002, pp. 236 - 240), Bermejo and García Durán (1994), and Trullén (1993, pp. 60-63). For the political events see Juliá (1991 and 1995) and Tusell (2003).
27. As explained by Lagares (2002).
28. See Lagares (2002, pp. 586-600). For the evolution of expenses see Pan-Montojo (2002, pp. 230-235).
29. According to Fuentes Quintana (1993).
30. They are the Institute for Fiscal Studies's reports prepared under Enrique Fuentes Quintana (1973 and 1976b) and entitled "Report on the Spanish Taxation System," presented in 1973 and "Spanish Taxation System. Criteria for their reform" completed in 1976.
31. See Trullén (1993) and Valiño (1989).
32. See Pan-Montojo (1996) and Cabrera y del Rey (2002, pp. 339-349).
33. Lagares (2002 and 2004).
34. Nevertheless an important step was taken with Law 40/1977 on September 7th which created the *Cuerpo Especial de Inspectores Financieros y Tributarios,* (Special Corps for Financial and Tax Inspectors) that unified the old tax inspection corps.
35. See Fuentes Quintana (1991).
36. See Pan-Montojo (1996 and 2002).
37. See Fuentes Quintana (1990) and Comín (1990).
38. There was a precedent in Spain for this in the 1845 tax reforms. See Comín and Vallejo (2002).
39. See Pan-Montojo (1996, pp. 275-296).
40. According to Fuentes Quintana (1991).
41. See Albi and García (2001, pp. 61-64).

42. See Gago et al. (2002, pp. 257 - 265) and Albi (2004).
43. See the articles of numbers 30-31 of *Papeles de Economía Española,* 1987.
44. Complementary income tax (surtax) was created in 1932 and in 1964 it became General Income Tax but direct taxation was still focused on prepayment of traditional tax schedules, because General Income Tax still was a schedular tax. Although the 1964 reform expanded the name of the income tax by adding the adjective 'general' to substitute 'complementary' it reduced its receipts from 1.5percent to 1.2percent of the Central government's revenue.
45. Corporate Tax appeared in 1920 when tariff III of *Contribución sobre las utilidades de la riqueza mobiliaria* (The Taxation of the utilities of movable wealth was a tax on salaries, capital yields and corporate profits created in 1900) and it became an independent tax in 1957 during Navarro Rubio's first tax reform.
46. See Albi (1987 and 1994) for the taxation on companies that was not heavy because of Corporate Tax but rather because of the employers' contribution to social insurance. See González-Páramo (1990c).
47. The Public Administration's capacity to enforce taxes and impose sanctions improved as of 1983 and from 1986 onwards because they had the help of VAT as an element of control for the Personal Income Tax, especially the incomes of professional and small businesses. Sanctions on tax fraud also increased in 1986.
48. Comisión para la Evaluación del Fraude (Commission for Tax Fraud Evaluation) (1986), Instituto de Estudios Fiscales (1989), Lagares (1991), Díaz and Romero (1994), Fuentes Quintana (1990) and Zubiri (1991).
49. Statements of the Secretary of State for Public Finance in the *Cortes*, *El Independiente*, October 4. 1990; *El País* October 4, 1990.
50. Fuentes Quintana (1990, pp. 264-265 and 558-577).
51. Alvira and García López (1981 and 1987). The levels of coverage of public services appear to have been quite insufficient at the end of the 1980s. See Lagares (1988).
52. See Repullo (1991 and 1986).
53. The information available for the mid 1980s shows, on the one hand, that almost two thirds of the taxpayers needed external help to complete their income tax returns. On the other hand, the high number of taxpayers' appeals against the collection of Personal Income Tax indicated that the Tax Administration also had problems managing it. Inflation, the accumulation of income in married couples and irregular incomes, all circumstances that were present in Spain as of 1979 complicated even more the enforcement of the Personal Income Tax (Fuentes Quintana, 1986).
54. In 1985 half of the people filing tax returns asked for a return and the differential quotas that are withheld when the tax is paid were around 12 percent of the collection.
55. Fuentes Quintana (1990, pp. 569-573).
56. See Enrique Fuentes Quintana (1991), González-Páramo (1987, 1990a and 1990b) Albi, Rodríguez and Rubio (1987), Albi, Rodríguez and Rubio (1993) and Valle (1989).
57. The withholdings on capital yields were progressively reduced to 25 percent (in 1990) until it reached 10 percent in 1993; see the Statement of Mr. Borrell, Secretary of State for Public Finance, *El País.* May 20, 1990.
58. See Ministry of Finance (1990a and 1990b).
59. Ministry of Finance (1990 a, pp. 37 - 41). See Borrell (1986 and 1990) and Boyer (2004).
60. See Comín (1996b).
61. Nevertheless, with the system implemented in 1991, capital gains could be fully exempted. From 1996 on every capital gain pays taxes whereas before 1996 this could not be the case.
62. See Rubio (2002, pp. 300 - 307), Lagares (2004), Lagares and Castellano (2004), Castañer, Romero and Sanz (2003), Sanz, Castañer and Romero (2004), González-Páramo and Sanz (2003a y 2003b), Onrubia and Sanz (2003) and Albi (2001).

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