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The Uruguayan Tax Reform of 2006: Why Didn't It Fail?

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Introduction: The Will, the Hurdles, and the Success

This article explores the success of Uruguay's 2006 tax reform in (re-)introducing a comprehensive and progressive personal income tax while re-balancing direct and indirect taxes, eliminating inefficient taxes, and strengthening tax enforcement and compliance. It examines two sets of factors consistent with available evidence, and builds on a previous essay on the topic (Rius, 2012), also exploring in greater depth a few of the key facilitating and complicating factors of the reform's success. In particular, this paper focuses on (i) perception biases that caused a divergence between the reform's distributional effects and middle class voters' attitudes and (ii) the response of the top income sectors to the increases in their tax bills. Though Latin American countries clearly differ in many dimensions regarding the outcomes of tax reform efforts, this article attempts to show that the Uruguayan experience of the late 2000s contributes several tactical lessons of value to other reformers.

Uruguay's progressive tax reform meets several conditions for success that have been identified in the literature. Specifically, it was carried out in a relatively egalitarian society (by Latin American standards), led by a disciplined left-of-center coalition (some political scientists consider it a "party") with an absolute majority in Parliament, and had a clear blueprint for reform.[1] Although raising additional revenue was not the main objective of the 2006 reform, its intention to increase the resources available for the expansion of social protection to those most affected by the 2002 crisis was discernible in the background. Starting from a comfortable fiscal position, the reformers had some leeway to design a more efficient and equitable regime, while minimizing the number of "losers" (i.e., those that would end up paying more in taxes after the reform than they paid before the reform). Moreover, at the time of

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the reform push, the country was enjoying strong growth and a stable macroeconomic environment which made it unnecessary to borrow from the international financial institutions. This meant that opponents could not attribute the reform to external pressures, an argument that has often undermined reformers, especially when they come from the political Left. Instead, the reform could be reasonably depicted as home-grown, which it largely was.

The main features of the reform included (i) the replacement of several schedular taxes (taxes specific to certain types of income) with a new unified personal income tax; (ii) the consolidation of corporate income taxes on agriculture and other economic activities into a single tax at a rate reduced (from 30 percent to 25 percent) to match the top marginal rate for personal incomes; (iii) the reduction value added tax (VAT) rates and the suppression of a related cascading sales tax, with the removal of exemptions for specific services; (iv) a revision of exemptions and rates for the net assets tax (maintaining a high ceiling for exempted assets and a very low rate); (v) other minor innovations or corrections to the previous patchy regime. In general, special treatments for economic sectors were abolished or restructured as an investment promotion regime that was to be debated and decided later (for example, the reform eliminated all exemptions to the employer contributions to the pay-as-you-go pension system). The reform reduced the role of indirect taxes and increased that of direct taxes (although the ratio between the two is still very high after the reform at 2:1), while significantly amending vertical and horizontal inequalities of

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the direct taxes and setting the foundations for future incremental adjustments towards greater progressivity across the whole taxation structure.[2]

The reason for the lack of significant and enduring opposition to the 2006 tax reform by those who were certain to face higher taxes or believed that their tax bill would be raised was not obvious at the time of reform and still remains unexplained. The first section of this paper argues that the tax reform was prone to a hostile reception from large segments – possibly a majority – of the electorate, despite the administration's high standing in opinion polls and the care taken to present the reform as globally revenue-neutral and beneficial to a large majority of non-rich taxpayers. To understand the spread of hostility it is necessary to consider the literatures on behavioral economics and the behavioral political economy of fiscal policies. These disciplines characterize voters/consumers as possessing limited information gathering and processing capacities, and unable to discern the net gains from complex reform packages. The paper argues that it is also crucial to consider biases in the self-perception of individuals' own position in the income scale, revealed by recent empirical studies. This section then suggests reasons why, despite the negative initial attitude of the population, the implementation of the tax law could move forward without major social upheaval. In particular, the paper examines why there has not been a social "movement" seeking a return to the pre-reform or similar tax regime, and why there has not been such a resistance to even the most controversial element of the 2006 reform, the new personal income tax.

The second section of the paper focuses on the response of Uruguay's richest minorities. It aims to identify a coherent set of reasons why the sectors that actually experienced a negative net change in disposable income did not mount a more determined opposition to the reform. Essentially, it points to the relative weakness of the upper strata of society in Uruguay, most clearly evident when this cohort is compared with similar segments of other countries in the region. The paper argues that Uruguay's wealthiest sectors are weaker in terms of their capacity to block adverse reforms because (a) they are ideologically and organizationally divided, (b) they have sparse social and familial inter-linkages with the political elites, allowing the latter to enjoy greater autonomy, and (c) the political parties are highly institutionalized and heterogeneous in their social makeup, complicating certain forms of influence from the rich. These and other related factors made a powerful response from the "losers" of tax reform difficult and is part of the explanation for the high level of compliance with the 2006 reforms. The hypotheses outlined here are not tested in this paper, but their plausibility is examined in light of relevant literature and available evidence, as well as by analyzing a recent natural counterfactual to the 2006 reforms, involving a more limited tax reform in 2012.

It is worth noting that despite the emphasis of the explanations contained in this paper on the influence of structural features of Uruguay's society, polity, and economy on the success of the 2006 reform – features that would seem difficult or impossible to change by deliberate intervention – it is nonetheless possible to draw practical lessons for other progressive reformist endeavors. The paper concludes by highlighting some of these more broadly applicable lessons.

Mass Public Opinion: Why the Middle Class Couldn't be Won but Wasn't Lost

At the time of the public debate on the tax reform legislation, a variety of actors argued that the reform could affect the middle classes disproportionately (or seem to have such an effect), creating the risk of political blockage or a post-election reversal (see Rius 2012, particularly the quotes from those instances). These prospects troubled reformers, who anticipated adverse public opinion based on popular perception rather than fact would limit their success. Some numbers justified the reformers' concerns, giving rise to a political economy paradox.

Table 1, below, presents ex-ante estimates of net effects of the complete reform (including changes in direct and indirect taxes) on households' income, by deciles, based on static simulations run with 2004 data by the very competent economic analysis unit of the Uruguayan tax administration agency (DGI). The first two columns show that all but the top two income deciles could expect a small reduction in their total tax bill, and only the top 10 percent of households were expected to experience a large enough variation in tax burden to be discernible (more on this below). While there were prospective "losers" in all the deciles, they represented less than 10 percent of households in the first six deciles and were still an absolute minority up to the ninth; only in the top decile was there an absolute majority of about 80 percent that could expect to pay more taxes after the reform than before. Overall, the whole reform would leave 85 percent of households better off than they were in the pre-reform situation. Table 2 depicts similar expected outcomes specifically from the substitution of the new *Impuesto a la Renta de las Personas Físicas* (IRPF, personal income tax) for the pre-reform payroll tax (IRP). It shows that on average, effective tax rates could be expected to decline after the reform for households in the first seven deciles, and increase only for the top three.

The paradox starts to take shape when those results are paired with the evidence from public opinion polls conducted contemporaneously with the process of reform and implementation. Table 3 presents such evidence in its simplest form,

TABLE 1
BEFORE AND AFTER REFORM TAX BURDEN
AND PERCENTAGE OF WINNERS/LOSERS BY DECILES

Deciles of households by per capita income	Total tax burden by deciles		Percentage of winners and losers with reform	
	Before reform	After reform	Winners	Losers
1	13.5	10.1	99.33	0.67
2	13.8	10.3	99.36	0.64
3	13.8	10.3	98.96	1.04
4	13.7	10.3	98.26	1.74
5	13.3	10.3	96.98	3.02
6	13.1	10.5	93.62	6.38
7	13.7	11.7	89.08	10.92
8	13.8	12.5	79.99	20.01
9	13.9	14.3	59.13	40.87
10	12.8	17.8	20.66	79.34
All the population	**13.4**	**13.3**	**83.54**	**16.46**

Source: based on González Amilivia (2007)

TABLE 2
EX-ANTE EFFECTIVE TAX RATE FOR PERSONAL INCOME TAX VS. ITS PREDECESSOR

Deciles of households by per capita income	Ex-ante, per capita effective tax rate (percent)	
	IRP (pre-reform payroll tax)	IRPF (new, global income tax)
1	0.35	0.29
2	0.95	0.52
3	1.27	0.32
4	1.38	0.52
5	1.65	0.85
6	1.80	1.18
7	1.95	1.71
8	2.41	2.64
9	2.68	4.28
10	2.85	9.07

Source: González-Amilivia (2007)

regarding the most salient new tax in the reform package – the IRPF.

The table shows that almost an absolute majority opposed the personal income tax, before and a few months after the tax legislation was passed in December 2006, even though it was at the center of a reform that had many more winners than losers and could be shown to be less burdensome than prior taxes for about 70 percent of households. Table 4 confirms that the paradox did not result from misguided forecasts, as the ex-post incidence studies show distributional patterns almost identical to the pre-reform simulations.

In summary, professional judgments anticipated modest gains from the reform for a vast majority of taxpayers, and those expectations were validated by ex-post incidence studies on the effects of the reforms two years after their enactment. Yet, opinion surveys showed a plurality of taxpayers (almost an absolute majority) were against the core of the reforms (IRPF, the personal income tax), and were likely against the reform as a whole. This paper tries to unravel this paradoxical picture.

Insights from behavioral economics and from an emerging behavioral political economy of fiscal policy make such unraveling easier (Kahneman, 2011; Thaler and Sunstein, 2008; Slemrod, 2009; Congdon et al., 2011). These behavioral approaches emphasize the following points:

i. People cannot accurately calculate the direct and indirect effects of complex policy innovations such as a comprehensive tax reform, so their decisions will be based on some combination of rules-of-thumb and heuristics that cannot be guaranteed to be bias-free;
ii. Limited cognitive and calculation capacities make people vulnerable to perception biases, in particular biases regarding their relative social status;

TABLE 3
OPINION ABOUT THE IRPF IN THREE NATIONAL SURVEYS
(*In percentages*)

	Nov-2006	Apr-2007	Sep-2007
In favor	27	23	29
Neutral	11	12	12
Against	47	47	49
DK/DA	15	18	10
Total	100	100	100

Source: CIFRA, González Raga y Asociados; http://www.cifra.com.uy/novedades.php?idNoticia=17 accessed January 31st, 2012

TABLE 4
EX-ANTE EFFECTIVE TAX RATE FOR IRPF VS. EX-POST NET GAINS FROM ALL TAXES ON INCOME

Deciles of households by per capita income	Ex-ante, per capita effective tax rate (percent)	Ex-post direct taxes over market income (in 2009, percent)
	IRPF (encompassing income tax)	All taxes on incomes, excl. pension contrib.
1	0.29	0.4
2	0.52	0.9
3	0.32	1.3
4	0.52	1.7
5	0.85	2.0
6	1.18	2.4
7	1.71	3.0
8	2.64	3.9
9	4.28	5.3
10	9.07	9.0

Sources: First column, González-Amilivia (2007); second column, Bucheli et al. (2012, Table 5, third col.)

iii. Humans in a social setting dislike material losses more than they value identical gains; i.e., they suffer from "loss aversion" (a case of the more general problem of "reference-dependent preferences," Congdon et al., 2011, pp. 35).

We can safely speculate that most taxpayers were unable to put exact numbers on their expected gains and losses from the reform, even where those calculations were relatively simple. Slemrod (2009), for example, has pointed to evidence that voters often confuse marginal with average tax rates, and we could be almost certain that most Uruguayan taxpayers were unable to figure out the complex effects of all the taxes that were changed, created, or eliminated in 2006. It takes even trained economists a considerable amount of work to do these calculations for simplified "types" of taxpayers, based on tested methods. Moreover, even if taxpayers had known and understood the calculations behind the figures in Table 1, they might have been inclined not to spend time and money to find out the exact amount they would have to pay under the new versus old regimes, or they might have defaulted to a preference for the status-quo, resulting from well-documented loss aversion and a zero-centered distribution of their possible personal outcomes.[3]

Yet a second behavioral factor would seem to have had (and may continue to be having) even deeper consequences. At the time of the 2006 reform, professional economists found, to their surprise, their interlocutors at cocktail parties or family gatherings would point to their own expected increase in the tax bill as proof that the reform had been poorly designed and was going to hurt the middle class – such claims were often supported by limited or no evidence of the speaker's position in the social scale, and tended to rest on vague references to new taxes created or new income sources taxed. Reformist politicians (particularly some at the helm of the Ministry of the Economy and Finance) lamented being unable to convince the middle classes of the reform's benefits to them, and expected (at least until the 2009 elections) that the criticisms from the middle class would cost them dearly in terms of electoral support. With the benefit of hindsight, this paper argues that it was probably impossible for the government to win "the battle for the middle class," but that the combined outcomes of the 2006 reforms do not really represent a defeat, and that they offer lessons for similar tax reform processes.

Cruces et al (2011) have carried out a noteworthy empirical investigation of self-perception biases of individuals' relative positions on an income scale. Their study is based on a representative sample of the population of Gran Buenos Aires (Argentina), a convenient comparison because of the important historical, cultural, and socio-economic similarities between that nearby region and Uruguay. We can therefore borrow some of their key insights to interpret the paradox described above.

Cruces and his collaborators interviewed about 1,100 residents in Gran Buenos Aires and presented them with the following question: "There are 10 million families in Argentina. Of those 10 million, how many do you think have an income lower than yours?" The response to this question became their indicator for "subjective" self-positioning on the income scale. They also asked for information on actual income, getting interviewees to place their household in one of ten brackets of total income, defined by the actual decile thresholds from the latest national living standards surveys (which are believed to be accurate and also previously unfamiliar to the interviewees). This gave researchers the individuals' "objective" position in the income scale, as a challenge to their subjective or perceived position.

This research showed large divergences between the subjective and objective position of households in Gran Buenos Aires at both extremes of the actual decile scale, with people either the highest or lowest income levels believing they are closer than they really are to the median. On average, for example, people belonging in the first (lowest income) decile tend to feel they are more than three deciles higher. This divergence decreases monotonically as one moves towards the median of actual incomes (i.e., top threshold of the fifth decile). From the other end, those in the top decile believe on average that they are part of deciles six or seven, for an average perception bias of -3.15 (i.e., the difference between perceived and actual decile for those at the top is slightly over "minus three deciles").

How do these results, along with the contributions from behavioral economics and public finance, help us to understand the success of Uruguay's tax reform of 2006? First, they suggest a context in which it was extremely unlikely that taxpayers could know the precise effects of the reform on their disposable income. The calculations necessary to estimate the effects of the reform required capacity to understand legal and economic jargon, and to carry out complicated operations. It is not a very difficult assumption to make that most citizens/taxpayers could not undertake those tasks, even if they had access to the required documentation and data. The minority of the population with the skills and inclination to run some of the required calculations could be safely assumed to be heavily concentrated in the top income strata; even that minority would have serious trouble discerning the *relative* burden for even a few income strata. (We are speaking, of course, about individuals and not companies, which depending on resources could have access to expert advice.)

Moreover, had they been reached by the messages from the government which conveyed the small expected impacts on most households (i.e., estimates such as those of Table 1), taxpayers might have been suspicious about the source's intentions or could have removed the whole issue from their "agenda" given the low significance of the aggregate changes. For all these factors, it is unlikely that all but a fraction of the top income earners would have some minimally precise idea about the expected changes in their tax bill.

On the other hand, the high response rate in the Cruces *et al*. study suggests that voters think they know their position on society's income scale, although – as we saw-- they know it with substantial and systematic error. The combination of biased perceptions of relative income and rational inattention, calculation constraints, and complex innovations, could mean (i) rich voters that recognize the increase in taxes that they will face and deem it unfair because they see themselves "middle class;" (ii) other voters at the top and near the middle of the scale that are uncertain about effects and thus are not sure how to react or favor the status quo (see next); and (iii) poor voters that cannot see that they will be exempt but feel middle class and fear being taxed.[4]

With incomplete information, biased perceptions and limited rationality, voters would have to make choices and form an opinion in a world of uncertainty, particularly regarding their individual outcomes. Asked to support changes to tax policies for their greater transparency, efficiency and fairness, those taxpayers might choose the status quo fearing losses since they are felt more dearly than similarly-sized gains: Even if knowing the majority of household will be "winners" in the new tax framework, uncertainty about their individual outcome will throw taxpayers into a potentially opposing majority.

The data from Cruces *et al.* (2011) also shows that, based on average responses, almost the whole population could be thought as placing itself within plus-minus 3.5 deciles from the median (see Table 5), which is about the space of the middle classes according to recent academic research (see for example, the literature reviewed in Hopenhayn, 2010). In other words, discourse based on the preservation and expansion of the middle classes resonates well with the majority of public opinion, but also has an effect when the likely consequences of the reforms are laid out in more "objective" terms, as almost all the population believes themselves to be part of the unjustly taxed strata.

TABLE 5
OBJECTIVE AND PERCEIVED DECILE BY "OBJECTIVE" DECILE IN SURVEY OF RESIDENTS OF GRAN BUENOS AIRES, IN CRUCES ET AL. (2011)

"Objective" deciles	Average perceived decile of interviewees in the respective objective decile	Average bias
1	4.5	3.5
2	4.7	2.7
3	4.5	1.5
4	5.5	1.5
5	5.4	0.4
6	5.4	-0.6
7	5.7	-1.3
8	6.1	-1.9
9	6.3	-2.7
10	6.8	-3.2

Source: Cruces et al. (2011)

The previous findings are the reasons that the "battle for the middle class" could not have been won by Uruguay's reformist government. Yet, it wouldn't be accurate to describe the situation as a total defeat. First, the responses of civil society and political actors to the reform were real and vocal for a while, but became increasingly quiet as time passed. The reform was indeed formally challenged in several lawsuits sponsored by organizations of pension beneficiaries. The Supreme Court initially ruled that the application of the personal income tax to pensions was unconstitutional. However, after the scheduled replacement of one of its members, the majority opinion of the Court was about to change. Since in Uruguay constitutional rulings only affect those who have filed the suit, the government faced the prospect of having otherwise identical citizens facing different tax burdens, at least until everyone had sued. Neither was it prepared to absorb the loss of revenue that this setback implied. The government then worked with the parliament to pass new legislation replacing the IRPF on pensions with the newly created IASS (social security tax), with similar material effects. The new tax was also legally challenged but, with the new composition, the Supreme Court ruled in 2009 that the IASS was not in conflict with the Constitution.

The opposition and pension beneficiaries' organizations made announcements that they would seek a constitutional amendment to establish the prohibition of *any* taxes on pensions. They even threatened to resort to a national referendum to repeal the laws, despite the fact that such a direct democracy mechanism cannot be used to question the creation of taxes. Interestingly enough, the majority of pensioners were not among the worst hit by the tax reform (although many of them may have been higher on the income scale than they believed themselves to be). What this group had that other segments of Uruguayan society did not have was the necessary cohesion and institutional capacity, built on past victories (i.e. pay-as-you-go pensions were tied to the average wage index in 1989, after a popular initiative supported that measure in the polls) and the electoral power of a sizeable constituency with unified interests.

Second, the 2006 reform was not actively resisted by trade unions or other economically active groups when it began to have material effects in July 2007. This suggests that the expectations derived from ex-ante simulations were largely validated and the taxpayers could see them reflected in their paychecks (although there is an additional behavioral interpretation for this result, proposed below). The modest positive effects experienced by the majority of taxpayers might not have been enough to make them happier, but certainly did not cause the majority to feel abused.

Third, and most importantly, had there been deeper and cumulative resentment from excessive burdens or injustices contained in the new tax regime, it would have been much more difficult for the governing coalition to be re-elected with an absolute majority again in 2009. In this sense it is worth recalling that only a few months before the election, the united pensioners were still fighting the new taxes in the Supreme Court, and even this situation was not enough for any opposition candidate or party to make substantial gains on a platform prioritizing the reversal of the reforms.

At least when considering these three facts, it can be said that the "battle for the middle class" would have been essentially impossible to win, but was not lost. For the benefit of other reformist processes, we can draw several factors from the Uruguayan case that would seem to have helped avoid outright reform failure.

a. As soon as the new law was passed, the government – through the tax collection agency (DGI) – implemented a broad and systematic national information campaign, not just broadcasting slogans or abstract arguments, but setting up advisory services throughout the country that allowed taxpayers to find out exactly how much in taxes they were going to pay under the new regime. This was a direct and eventually effective response to some of the cognitive limitations that behavioral economics emphasizes, and to the very specific challenges posed by a complex set of fiscal policy changes.
b. The economy was growing rapidly, and taxpayers are known to have difficulty discerning between causes of monetary

changes when they operate simultaneously and are of varied sign and size. It is important to take into account that the country's rapid economic growth obscured the specific effects of the reform for at least some skeptics, and perhaps also for some of the modestly losing taxpayers. Strong growth may have had a reinforcing confounding effect, on top of the effect of evidence and information.

c. Many taxpayers may have just confirmed in July 2007 that the effects of the reform on their situation were in any case not significant enough to worry about. This conclusion would not have been the result of complex calculations but would rather reflect the confirmation that they and their fellow citizens were still receiving a very similar level of income since life went on for them and their employers/peers/clients without any disruptions. We do not know for sure what role this played, but consumers have been found to worry more about relative than absolute changes in actual or achievable consumption (Duesenberry, 1949; Graham, 2005; Frank, 2007). If those "changes" are small and in any case shared by many of a similar status, the relative consumption foundation of happiness and psychological well-being might have played in favor of the lack of mass opposition.

d. Some taxpayers who felt a decline in their net income may have acquiesced to the reform based on "fairness" considerations. Experiments run by behavioral economists have shown that fairness plays a more significant role in many individuals' decisions than it is generally acknowledged in mainstream microeconomics. The reform came after a left-of-center coalition won a national election for the first time in the country's history, and progressive redistribution was a part of the platform of a political organization that could only have received more than 50 per cent of the vote with some support from relatively wealthy voters (more on this below).

While this paper has provided no empirical test of these hypotheses, they are congruent with the data presented above; if they can be considered plausible, they have original policy implications – which will be discussed in the last section. First, however, this paper will focus on the response to the 2006 tax reforms from those who were certain to pay more taxes under the new regime.

The Upper Strata: Divided, Disorganized and Powerless?

The success of the Frente Amplio's government in passing the tax reform of 2006 raises the issue of why it elicited only a weak public response and no meaningful or lasting opposition from the social segments that were most negatively affected by it (that is, those minority but influential segments at the top of the income and wealth scales, which saw their tax burden increase as a consequence of the reform and had the political resources to act against it). Uruguay has a rich history of collective action to oppose economic reforms through institutional channels and, as will be shown below, that history was far from over at the time of the 2006 reform. Why then did the wealthy not try to stop the 2006 tax reform through formal political mechanisms?

Moreover, institutionalized collective action is not the only political alternative available to the richest strata of society. Typically, the upper classes can influence the policy process through various informal means (for example: influencing the media to cast a negative shadow on the proposed reforms or the reformers, threatening to withdraw support and financial contributions in the next election, etc.). However, if such means were tried, the force with which they operated was far from insurmountable for the reformers, and in the end any protest proved ineffective to stop the legislation from being passed and the reforms from being implemented.

Those negatively affected by the reform could be anticipated to be a minority of the population (less than 20 percent), but they were not *any* minority.[5] As a group, those harmed by the reform were households at the top of the income scale, which have a strong voice and multiple direct and indirect channels through which to influence policy making and political processes. In addition to their normal clout, this segment of society could have taken advantage of the reasonably common viewpoint that the reform was contrary to the interests of the middle class and thus mobilize support from those so self-identified.[6] In such circumstances, it might have been possible to put together a winning coalition against the reform. In fact, Latin America's experience shows that, without the richer social segments' acquiescence, even limited progressive reforms tend to stall or die (which has been the experience of Guatemala, as well as Costa Rica and Chile; see Gómez Sabaini, 2006; Fairfield, 2010; and ICEFI, 2012). So, why is it that the affected sectors did not react more emphatically and effectively in Uruguay?

This paper lays out below a coherent set of hypotheses to answer the previous questions, and provides some "soft" evidence to argue their plausibility, building on previous work by several authors (Fairfield, 2010; Mahon, 2004; Arnson and Bergman, 2012, and the contributions summarized there; and Rius, 2012). The intended contribution to that literature would follow from the addition of another case study (here, of *a successful progressive reform*), the attention paid to social, political and economic factors, and from exploring the potential of a behavioral economics approach to the political economy of reforms.

In the literature, the upper strata are assumed to have some form of power to condition the success of progressive reforms, but the foundations of such power, and specifically how that power is exerted, are not always clear. In some of the studies, the business sector is understood as an encompassing and complex entity, including its visible organizations (e.g., industry-specific business associations), but also the corporations and smaller firms that are more or less represented by these organizations, and (mostly implicitly) also the households classified in the top percentiles of the wealth or income distributions. This paper tries to be more specific about those terms. While the previous section dealt essentially with richer households and their role in broader "mass" opinion, the following pages will examine the political influence of "business" understood and referred to as *organized and formal pressure groups as well as more informal lobbying activity sponsored or undertaken by firms*. When we speak of the upper classes, economic elites, upper segments of society, or "the rich," we envision *individuals with the greatest wealth and incomes*, who may or may not be active in business organizations or feel represented by them or by corporate leaders. Our hypotheses are largely informed by the Uruguayan case, but take into account some comparative evidence.

We propose that the reform of 2006 succeeded because Uruguay has an ideologically and organizationally divided upper class which failed to overcome the collective action challenges of confronting a majority government. The level of fragmentation of the upper strata in Uruguay is thought to be a long-lasting feature of the country's socio-economic structure that is logically related to (although it does not require nor is determined by) a low density of personal and family inter-linkages between economic and political elites.

The latter contributes to the fact that the economic and the political elites are (usually) largely separate categories, and to the relatively high autonomy of most political actors from business interests. On the side of the political system, this paper argues that a highly institutionalized and catch-all party system prevented the upper strata from obstructing the reforms.[7] In a way, our analysis of the response (or lack thereof) of the wealthy and business as a collective actor has a lot in common with Fairfield's (2010) examination of Chile, particularly on the sources and role of "instrumental power," although we might expect the sources of such power to be more stable than suggested in that work. In broad terms, Uruguay could provide a fitting counter-example to Chile.

This characterization of the upper strata of Uruguayan society comes largely from Real de Azúa (1969). He describes the emergence of differentiated upper classes in the nineteenth century and their trajectory up until the late 1960s in terms that shed light on the possible causal channels that connect economic inequalities with the behaviors of elites. He outlines factors that account for the lack of ideological cohesion among elites and the relative disconnect between the economic and political upper classes. Regarding the former, he highlights the effects of weak religious observance founded in an adherence to Enlightenment values among the groups of Hispanic settlers that established themselves on the eastern side of the De la Plata River. The weak influence of Catholicism would have distinguished the social milieu in Uruguay from that in neighboring countries (Real de Azúa mentions Argentina; we would add Chile).[8]

Subsequent immigration flows from a variety of economic and cultural traditions and a relatively upwardly mobile society did not contribute much to the unification of ideas and values in Uruguay or the elites' sense of belonging to a single social category. Mobility derived from the nature of the elites' assets and the political upheaval that characterized the country for the half century after independence: internal and international armed conflicts periodically depleted "traditional" rural wealth (through their effect on stocks of cattle and other rural property), and the ascent of the local mercantile elites was checked from colonial times by the uneven competition between Montevideo and Buenos Aires to become main hubs of regional trading networks.

The education system in Uruguay also prevented greater unity among elites. Well into the twentieth century, the absence of a concentrated and ideologically unified supply of primary and secondary education for the elites, as well as a hegemonic institution of tertiary education dominated by the state and middle classes (the Universidad de la República), prevented the economic upper echelons from acquiring ideological cohesion through shared socialization, which is a key asset in coordinating collective action.[9] With such lack of unity in the domain of ideas, social dynamics failed to promote a denser network of personal and familial ties to connect different segments of the upper classes more tightly. Religious, ideological, ethnic, and partisan cleavages cut across economic categories with similar or sometimes stronger force than material interest, which also limited the traditional unifying power of intermarriage to develop a broader, unified elite. This historical lack of cohesion among sub-sections of the economic elites directly impacts their capacity for coordination, when most of the economic entities (companies, economic groups) are family-owned and family-run.

The weight given here to an account of Uruguay's upper classes written more than forty years ago could be questionable. However, there are at least two justifications for taking it quite seriously. First, while there has not been much recent research on the social configuration and behavior of the elites, the few studies available have not contradicted Real de Azúa's.[10] Moreover, even if one recognizes the changes that have taken place in Uruguay since 1969 – the collapse of the ISI model (*Industrialización por Sustitución de Importaciones*), the military regime of 1973-1985, and the new democracy-cum-globalization since 1985 must have had significant social impacts – the factors highlighted by Real de Azúa are of the kind that have lasting effects and change at almost glacial speed.[11]

Even this imprecise characterization of the upper echelons of economic power could explain the absence of any cross-sector, second-level organization representative of the broader "business" interests. This is despite the existence of sector organizations with reasonably high coverage of the respective constituencies. The most influential associations are found in the large rural property and production sector, with two historically distinct but frequently collaborating associations. Close in lobbying power also comes from the financial sector (in recent times populated exclusively by subsidiaries of foreign banks), and somewhat less from the manufacturing and the mercantile sectors (with distinct organizations for the domestic and international trade branches).[12] Attempts to aggregate and synthesize demands and develop coordinated action have not gone very far except under exceptional circumstances (such as the transition from military rule to democracy in the 1980s). The large size of bi-partite and tri-partite bodies in the local institutional landscape (that is, workers-employers and workers-employers-State) often reflects attempts to create enough seats to accommodate a plural business class whose members do not feel represented by a single or a few high-level associations.[13] In brief, the non-existence of a single organization representative of the larger and economically most significant business interests is not by itself the reason that explains weak resistance to the tax reform; instead, it symbolizes the lack of common views and the organizational power among the economic elites to pose a serious threat to a determined reformist government with enough legislative backing.[14]

The other side of the division and disorganization discussed above is a political system that has demonstrated high degrees of autonomy from the country's economic powers. That autonomy cannot be fully understood, however, without highlighting the comparatively high degree of institutionalization in the party system, as well as the mixed social makeup of the major political forces. In fact, Uruguayan political parties record some of the greatest longevity and vote share stability in Latin America (Coppedge, 2001; Luna, 2007). They have been characterized as fractionalized, but not to a degree much different from the parties in other stable democracies, and they have been capable of acting in a reasonably disciplined manner when in control of the Executive or in the opposition (González, 1991).

In terms of their electoral (and financial) support, no party can be identified as clearly the party of the wealthy (as much as no party can be credibly identified as the party of the working classes; Real de Azúa, 1969; González, 1991; Luna, 2007). Thus, in the 2004 election, there were segments of the upper classes prepared to endorse the policy program put forward by the Left, and therefore they were aware of the impending tax changes and took their potential adverse personal outcomes as the price of other valued reforms expected from the new government. In the language of financial analysts, many wealthier segments had already "discounted" the reforms. Also, the catch-all nature of the parties makes it more difficult for any opposition fraction to pick up the flag of an anti-reform agenda that could easily be construed as the agenda of the rich.

Party institutionalization and the effectiveness of campaign financing as a tool of instrumental power have also influenced the political representation of the richer strata. Uruguay lacks effective financing regulation to curb potentially overwhelming political influence from the better-off, but as they are confronted with institutionalized catch-all parties that tend to have heterogeneous agendas, the wealthy have chosen to hedge their losses rather than betting to win: they have traditionally spread their contributions across more than one competing force, which has weakened another channel through which they could have achieved something like a high-level veto power. This is very different from situations where actual contributions, or promises of the same, successfully motivate legislators to abandon their political party and create another political force capable of competing for greater prizes in the next election (to some extent, this describes a frequent phenomenon in, e.g., Guatemala). In brief, in Uruguay the political and party system had long-lasting features that are detrimental to the influence that the elite might want to have on the contents of a tax reform. This allows a party with the necessary electoral backing to introduce innovations that in other contexts would have died in parliament or outside it.

A Natural Counter-Factual?

Fortunately, recent developments in Uruguay have provided a real-world, confirming counterexample on the role of ideological and organizational cohesion in addressing collective action challenges. On November 29, 2011, parliament approved the law that would create the *Impuesto a la Concentración de Inmuebles Rurales* (or ICIR).[15] The tax was designed to be paid by individuals, households, or companies owning more than 2,000 hectares of land (in productivity-adjusted units) in specified, fixed, yearly amounts (in inflation-adjusted accounting units) per hectare, with the amount owed growing through four brackets of total area owned.[16] The proceeds were intended to be administered by local governments (*intendencias municipales*) and earmarked for investments in local roads and roads maintenance and improvement in rural areas.

While land assets are already taxed both at the municipal level (*contribución inmobiliaria*) and the national level (*impuesto al patrimonio*), the ICIR was meant to discourage the concentration of land ownership. Land concentration had been taking place in parallel with the boom of agriculture commodity exports and the establishment of large pulp and paper plants, effectively driven by acquisitions by corporations, investment funds, and wealthy Argentinean and Brazilian planters. Unlike other countries in Latin America, Uruguay does not face the pressure of forcibly displaced and/or a large and rapidly growing rural population, and some economic analysts doubt that land concentration that might have occurred is purely negative (Errea et al, 2011). Still, the political Left has historically questioned the uneven distribution of land and sees its further concentration as a driver of further population expulsion as well as a way of capturing rents from the resource-based export boom (in the past, it saw this as source of economic inefficiency; Instituto de Economía, 1970). From a technical point of view, the tax was designed to add to the progressive slant of the direct component of Uruguay's tax structure, but earmarking the proceeds of the tax for rural infrastructure largely enjoyed by those taxed may have been questionable (which made it politically more palatable but economically less progressive).

Unlike the IRAE and IRPF, the ICIR targeted the assets of a single segment of the upper strata. Even considering the changes in the property structure of Uruguay's productive land, the traditional large land holders and more recently arrived foreign entrepreneurs and companies clearly shared an interest in stopping the tax from taking effect.[17] The affected included a sub-segment of the economic elite – the medium and large land holders – which has a history of lobbying the public sector for (or against) measures that impact their profitability. The cattle-raisers and other owners and managers of large rural concerns have been organized into two major sector associations for more than a century, each one with a long tradition of unified thought and action. The Asociación Rural has traditionally represented wealthier *estancieros*, although it has often coordinated its actions with the less elitist Federación Rural, when they have perceived policy innovations as threats to the whole sector.

The reactions against the ICIR did not take much time to emerge. Some of the responses illustrate the new makeup of the rural interests: three of the early lawsuits were brought up by large companies that have diversified and non-traditional investments in which land has a variety of functions.[18] Soon after its approval in parliament, more traditional *ruralistas* had set up a basic organizational structure to promote the challenge of the new tax before the Supreme Court, on constitutional grounds. The two organizations encouraged and provided legal support to individuals willing to sue. As of November 20th, 2012, the Federación Rural was actively advising its members to comply with the law and decree (which had just been approved) but to file lawsuits, while organizing public events with legal experts to question the legitimacy of the tax, and issuing public statements attacking it.[19] The Supreme Court ruled late in 2012 that the tax was incompatible with the Constitution, as its linkage to local governments' revenues and expenditures contravenes their fiscal autonomy. The government has since been considering ways to replace it with a similar tax that does not conflict with constitutional principles.

The rapid and emphatic response of the *ruralistas* and their organizations to the tax marked a clear difference when viewed in contrast to the response to the approval of the 2006 reform. The greater cohesion of the smaller affected group and its representative organizations had a major role in accounting for that difference, which supports the above hypothesis about cohesion and veto capacity. Analysts who have explored the interconnections of the personal and business relationships of the economic elite (Stolovich et al., 1987) have argued that the development of familial ties are one of the important mechanisms of creation or consolidation of economic groups. This issue deserves detailed and careful analysis using evidence that is not readily available, but anecdotal evidence suggests that by this measure, Uruguayan elites are also less "cohesive" than those of other neighbor countries (e.g., Chile). This could be associated with the more limited sectoral diversification of Uruguayan economic groups with roots in agriculture-related businesses (Stolovich et al, 1987, pp.46-48). The mobilization of the *ruralistas* in 2012, compared to the acquiescence of larger affected groups in 2006, would seem to speak of a denser set of personal-business relationships around the larger *estancias*.

Finally, the ICIR has generated criticisms but the political system has largely avoided getting drawn into a debate easily portrayed as one between a fairness-concerned government and a limited group of owners of large (and huge) tracts of land. This situation is surprising given politicians' or parties' readiness to endorse a measure in exchange for generous campaign contributions. On the other hand, the mild response of opposition parties is very much in line with the parties' catch-all electoral base and the need to remain at arm's length from the richest.

Some Tactical Lessons

In the previous pages, we have presented evidence that helps understand why the progressive and comprehensive tax reform of 2006 in Uruguay did not fail, despite elites' discomfort, biased perceptions, and the expectations of a large constituency. Some of the factors thought to account for this widespread acquiescence may be considered historical accidents, and several others point to social, political and economic structures that cannot be easily changed by deliberate political action (at least in the short-term). That does not mean, however, that this analysis of the Uruguayan case cannot provide valuable insights for those attempting progressive tax reforms in similar contexts.

As argued by other articles in this series, the bounded rationality of taxpayers and policymakers seems to demand a careful administration of political capital and communications capacities to succeed. For example, where agents have difficulties computing the net effects of complex reforms, signaling becomes quite important. It will be easier for the public to believe that a government is committed to tax fairness if it is fighting evasion by the rich as much as it punishes evasion by the middle and lower social strata, while popular suspicions that the government favors the wealthy may extend to other aspects of the ruled-ruler relationship (for example, when the ruler explains the expected effects of the reforms).

The successful experience of progressive reform in Uruguay shows that perception biases make some battles unwinnable, but this does not mean they should be avoided, or that the supply of useful and understandable information does not matter. Informing taxpayers in very personal ways about effects of the new law on their purchasing capacity appears to have been a valuable investment in generating a climate that encouraged compliance. In an extension of their survey, Cruces *et al.* (2011) inform some subjects of their actual position in the national income scale, while others are not given such information. Those informed that they occupied a position lower than they believed themselves to exhibited greater support for redistributive policies than those who were not offered such information. This speaks to the value of information, even if many may choose not to listen to it or doubt the purposes of a government that offers such assistance.

Information is also important because there are taxpayers who accept and pay taxes out of a sense of fairness and duty. Moreover, if as some authors have come to believe (Duesenberry, 1949; Frank, 2007), consumers care more about relative than absolute consumption, then being able to make sense of comparisons with their reference group or relevant role models is quite important to taxpayers. A reform that has carefully considered and protected horizontal equity should be more easily accepted if that information is communicated effectively.

The experience of the upper classes, despite their unique historical roots in Uruguay, can still point to factors that reformers in other cases may be able to influence. For instance, socially diverse, catch-all political parties helped get the 2006 reform passed and consolidated, which could suggest that forming a diverse, progressive reform coalition that includes well-known, economically successful individuals and organizations may help neutralize discourses that aims construe the reform as a socially divisive innovation, or a disincentive to seek economic success.

Another contributing factor to the success of the Uruguayan reform seems to have been the absence of a unified opposing voice from the richest tiers of the wealth scale. This structural factor was leveraged strategically by the government when setting up an early "public consultation" on the principles of the tax reform, an endeavor undertaken despite the fact it was not required by legislation. The reformers claimed that this mechanism allowed them to have a transparent discussion on general principles, forcing those expecting special treatment under the reforms to justify it publicly.[20] This probably did not entirely save the reformers from having to listen to some of those demands afterwards, but they may have been less frequent than in a different scenario, and somewhat weakened by the transparency principle established by the government.

The reform of the Investment Promotion Regime was timed and specifically conceived to further weaken resistance from economic interest groups. In fact, the "public consultation" already saw contributors arguing their cases on the basis of jobs created and lost, or contribution to growth or export income. These discussions do not mix well with the reform of taxes on individuals and varied sources of income. The government's approach was to split the negotiations in two, actually aligning each segment with some but not all the key principles of the overarching reform package: while efficiency and equity were key issues around the 2006 law, promotion of investment was negotiated in another context, around the 2007 decree that re-regulated the fiscal incentives regime to promote investments. Thus, when individuals and firms (and consumption) are taxed according to their incomes/revenues and almost nothing else (except principles of equity, efficiency, and practical feasibility), demands justified by jobs to be created or protected in a specific sector are out of place. This separation also allows the second round to discuss some conditionality on the benefits granted. It can be reasonably assumed that the tactics of separating reform elements, transparency, and universalism work best with a divided economic elite, but should not be prematurely discarded with more cohesive elites.

In brief, recognizing the real capacities of humans and their organizations, and considering the socio-political channels that translate inequalities in wealth and incomes into effective powers in the policy arena, has opened an agenda that would be most profitably explored through systematic comparative analysis. The addition of just one case to a small, emerging literature demonstrates the richness of the comparative approach, and speaks about possibilities of refining the set of transportable generalizations into usable lessons.

Concluding Comments

In 2006, Uruguay succeeded in introducing a broad and progressive tax reform because the government had the required support in parliament, managed to overcome the legal challenge from pension beneficiaries, and was not confronted by the moderately hostile (and inflated) middle classes or by the upper classes which are historically weak and lack cohesiveness and leadership. Adept, but perhaps only partly intentional management of signals sent to perception-biased voters played an important role in avoiding an outright defeat in the "battle for the middle class." Information offered transparently and accessibly, and the simultaneous strengthening of a tax administration agency that does not seem afraid to investigate and pursue big players, conveyed some of the messages needed to turn moderate disagreement into acquiescence.

The reform has confirmed its expected distributive outcomes and almost six years after entering into force it seems very unlikely to be repealed by an ideologically contrarian government. The recent failure to sustain a new tax on concentration of land property has to be interpreted as partial confirmation that the broader-reaching reform profited from hard collective action problems faced by the wealthier, as the latter lack the cohesion, organization, and ideological affinity of the rural land-owners that brought down the latest tax. The government's own internal disagreements may have helped reach that outcome, at least if technical mistakes are interpreted as a reflection of a hastily designed proposal that did not benefit from broader constructive review within the ruling coalition.

While the structural weakness of the economic elites and upper strata, and their democratic convictions, cannot be easily replicated elsewhere, the Uruguayan case suggests that progressive reforms are more likely to succeed if a broad and diverse social coalition can be built to support it, including some visibly successful individuals and business organizations, and if the personal and corporate income design issues can be handled separately from the economic stimulus measures.

Endnotes

1. After more than three decades of competing unsuccessfully for the presidency but developing more support each election, the Frente Amplio, a coalition of parties and organizations from the Center-Left to the Left of the political spectrum, was led in 2004 by Tabaré Vázquez to a national victory without the need for a runoff. The coalition got slightly over 50 percent of the vote in the first round, which in a strictly proportional electoral regime meant exactly half plus one votes in each house of Parliament. Uruguay's quasi-presidential regime ensured that it could pass any economic legislation with its own votes, although this required a high level of discipline of its elected representatives, and the latter involved not minor internal negotiations given the coalition/party's political makeup.

2. The reformers (i.e., mainly the helm of the Ministerio de Economía y Finanzas, the senior managers of the tax authority and external advisors) introduced this perspective through the so-called "Enfoque Dinámico de Responsabilidad Fiscal", which essentially consisted in delaying technically sound additions to the reform until future revisions, as long as their revenue implications were negative or highly uncertain (interviews with Under-Secretary of Finance and Senior Economic Advisor at the time, recorded in 2011).

3. Fernandez and Rodrik (1991) early and elegantly formalized this scenario where the status-quo bias results simply from individuals' uncertainty about their own specific outcome, even when all the other parameters are common knowledge and the reform is expected to have more winners than losers.

4. Assuming that voters know the estimated net effects of the reforms for different deciles, and maintain the biased perceptions of their place in the income scale, the conclusions could be drastically changed: if a top income earner knows the effective tax rate for each decile but sees herself as belonging to the middle class, she will expect no or minor losses with the reform, and might support it. However, those cognitive and calculative capacities are seriously questioned by the evidence from behavioral economics, and particularly for the segment of that literature that applies the concepts to fiscal policies (Thaler and Sunstein 2008; Congdon et al 2011). I thank Jim Mahon for directing my attention to this point.

5. The estimates available of proportions of winners and losers come from the ex-ante simulations, since there are no panel data or other retrospective records to actually identify unambiguously those that faced an increased vs. a reduced tax burden. The ex-ante simulations gain validity from comparing some of their results with some ex-post incidence analyses (such as, e.g., those in Bucheli et al., 2012).

6. The top quintile or decile cannot be assumed to be socially homogeneous groups (see below on the use of "rich" vs "business"). Most consequential for our purposes is the uneven distribution within those groups of political resources and accurate information. Specifically, the hypotheses discussed below are compatible with the Cruces et al. evidence if it is assumed that the smaller, core sub group of *business leaders* or economic elites know with a narrow confidence interval their tax burden in different scenarios, but the rich in general do not. The arguments still require perception biases about relative standing, but are consistent with different interpretations of them (in particular, whether they come from miscalculation, cultural appeal or civic

attachments; I thank Jim Mahon for suggesting this possibility).

7. More generally, we hypothesize, but do not attempt to prove, that rather than causing the political phenomena, the more permanent levels of economic inequality (e.g., those that are revealed by averages and relatively stable positions in cross-country rankings) actually *result* from (also long-lasting) characteristics of the upper sectors and the political system (e.g., their ideological cohesion, the depth of the linkages between economic and political elites, and the relative autonomy of institutionalized and catch-all parties).

8. "El Río de la Plata y su virreinato fueron hijos de la España borbónica e "ilustrada", una filiación que los aleja mucho más que al resto del "reino de Indias" de las pautas de conducta y los valores de la Contrarreforma. Y esta excepcionalidad se acentúa grandemente en las tierras en que se desplegaría el Uruguay si se la compara con las huellas culturales ya impresas en lo que sería la Argentina. El cotejo es revelador no sólo con la zona centronorte, firmemente tradicional (aun hasta hoy), sino incluso con Santa Fe y con Buenos Aires, mucho más próximas, por múltiples factores, a los trazos que nos caracterizaron (Real de Azúa, 1969; p. 11)

9. "Nuestro sistema educacional no concurre espontáneamente a robustecer vínculos endogrupales de un sector superior. Piénsese, por contraste, en la influencia de las "public schools" inglesas o en las universidades de la "Ivy League" estadounidense." (Real de Azúa, 1969, p.40)

10. Among these, Stolovich et al (1987) could be thought to detect a greater concentration of power and more powerful elites, but that is largely an effect of the Marxian approach; it will be shown below that their observations can explain a counter example to the 2006 tax reform. Zurbriggen (2005), and the works cited there, by Carlos Filgueira, Gerardo Caetano and Jorge Lanzaro, mostly coincide with Real De Azúa on the limited power of business over the policy process, and the relative autonomy of the political elites. A classical contrasting view to Real de Azúa's, but one that needs qualifications from a comparative perspective and that is based on weaker evidence, is that of another "founding father" of Uruguayan sociology, Aldo Solari. He had claimed (Solari, 1956) that "Las clases altas, la burguesía propiamente dicha, es una clase altamente organizada y con una fuerte conciencia de su existencia. Esa organización se ha plasmado en una multitud de instituciones de las cuales aquí se indican las fundamentales. Vale la pena señalar, además, que esa organización puede rastrearse hasta la época de la Colonia. *Con esto no queremos decir que la movilidad vertical no haya existido en el Uruguay y que las mismas familias continúen a través de generaciones ocupando la cúspide de la pirámide social, como ocurre con bastante intensidad en algunos países americanos*. (…) Es cierto que la división de las clases altas en rurales y urbanas, y dentro de estas en comerciantes, industriales, hacen que no con respecto a todos los problemas las opiniones de la clase y de sus organismos sean unánimes; pero tal cosa se refiere a problemas que no afectan a la clase social como tal sino simplemente a determinados grupos de intereses que, dentro de ciertos límites, pueden ser contrapuestos." (pp. 260-62, emphasis added)

11. It is probably the case that new economic groups coexist with the old. For example, that seems to be the case in the agriculture and livestock industry. Yet, the persistence of the old (and very old, by the country's relatively short history) can be gauged from the relative influence still enjoyed (see below).

12. Emerging crucial actors in the business sector in Uruguay are the large multinationals responsible for recent major investments (e.g., in the pulp and paper industry), but their tax burden is *negotiated* with the government within the framework of a highly discretionary investment-promotion regime that allows them to claim almost a full freeze of their tax status at the time of signing the "investment contract." Many of the recent foreign direct investments are based on tax-free zones, all of what makes them relatively uninterested in the business taxations issues raised by the 2006 reform (although the reform and the investment promotion regime are not disconnected policies, and nor is their "political economy".

13. That is the case, for example, of the Consejo Superior Tripartito, that has government, unions and business representatives to oversee tri-partite collective contract negotiations, and has six seats for the each of the "social" actors (a single national labor confederation occupies the six seats for workers), to

accommodate the diversity of views from the private sector on matters of "industrial relations".

14. Indeed, some could argue that the reform benefitted the business sector by reducing the tax on corporate incomes (from 30 percent of the pre-reform IRA and IRIC to the 25 percent of the new IRAE). However, this would miss the point as the consolidated 25 percent rate was then "tied" to the marginal rate on the top IRPF bracket, to prevent tax arbitrage, and was then linked for the longer term to the debate on progressivity and the fair level of redistribution.

15. Law Number 18.876. It took the government twelve months to issue the decree that lays down the specific rules for the administration of the tax, which is symptomatic of internal disagreements that exist over this tax among members of the left-of-center coalition (see, e.g., Brecha *Digital*, 7 September 2012, http://brecha.com.uy/index.php/politica-uruguaya/515-teoria-de-la-interpretacion, accessed 26 March 2013).

16. The owners of (productivity adjusted) 2.000 to 5.000 hectares must pay 67 Unidades Indexadas (UIs) per hectare, those owning 5.000 to 10.000 must pay 100 UIs, and those owning more than 10.000 will pay 135 UIs per hectare. September 30th, 2012, the UI was 2,4570, and the US$ was 20.988 pesos per US$, so the amounts per hectare were equivalent to US$ 7,84; US$ 11,7; and US$ 15,80, respectively. The law defines a set of family ties and firm linkages that make the group a taxable entity, to prevent the avoidance of the tax through nominal proprietorship.

17. The incentives for collective action were not identical, though, as some foreign investors have their land covered by major industrial investment projects that have negotiated tax exemptions derived from size-specific clauses of the investment promotion regime. Those exemptions are contained in Investor-Government contracts that were thought to protect the firms from policy innovations, which eventually happened.

18. The first lawsuit was filed by one of the largest rice producing companies, which owns lad for its plantations. The second came from the Chilean-Nordic consortium Montes del Plata, that has been hoarding land for the tree plantations that will feed its large pulp and paper project in the West of the country. The third litigant was a group best known for running the ferries system between Argentina and Uruguay but which also owns a large dairy company. The second and third lawsuits were later dropped by the complainants, which happen to have multiple and major dealings with the government for their various business dealings.

19. http://www.elpais.com.uy/121120/ultmo-676895/ultimomomento/federacion-rural-recomienda-impugnar-impuesto-a-la-tierra/, and http://www.federacionrural.org.uy/ accessed November 24th, 2012.

20. Interviews with senior officials in the reform team at the Ministry of Finance. Various comments in this section based on those.

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