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The political economy of tax reforms

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Summary

In the Netherlands, major tax reform proposals sometimes are adopted and converted into policy, but often they are not. This policy brief focuses on why this is so. We analysed the economic and political factors that have played a role in the extensive system changes of 1990 and 2001 and in the not adopted reforms of 1991 and 2015.

Our study revealed that reform proposals are more likely to be adopted:

- if the proposed reforms are included in a government agreement;
- if there is sufficient support within society;
- if there are firm research results available showing the exact problem as well as the likely solution (the reform measure).

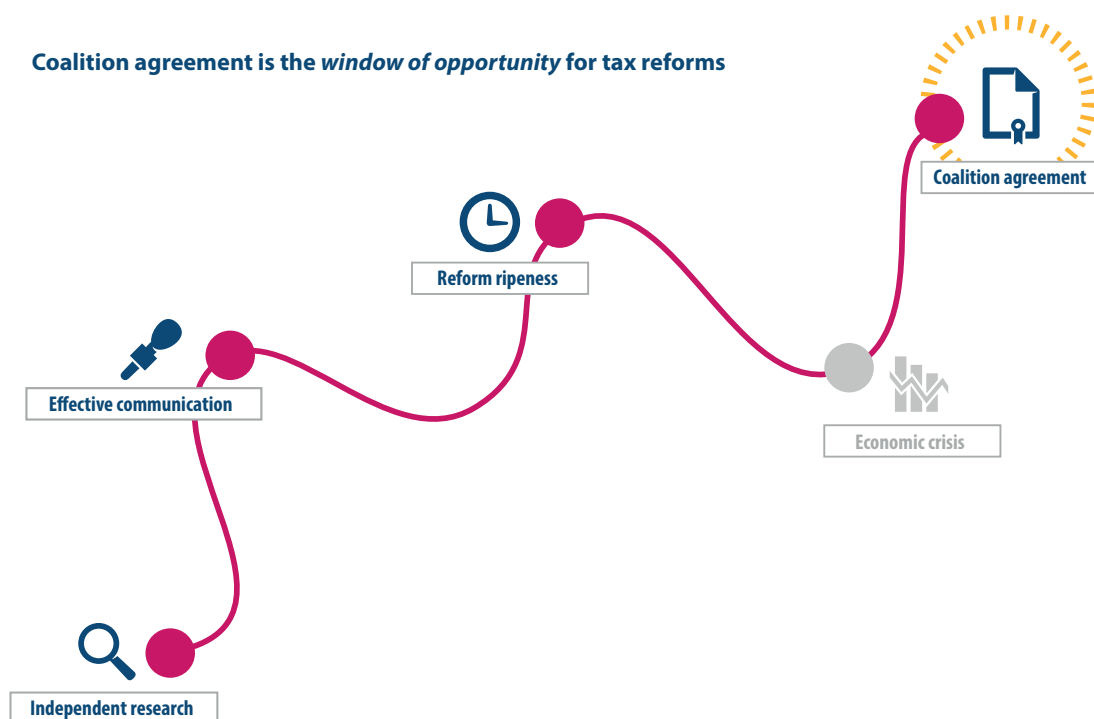
Other factors that are also important, but play a less decisive role are:

- whether there is a political majority in the Dutch Senate and House of Representatives;
- whether society is ready for reform;
- whether there is sufficient compensation for losers;
- political leadership;
- smart framing.

Furthermore, we studied whether the factors that influence an extensive system change had also played a role for individual reform measures, such as changing the vehicle registration tax into a tax on the emission of CO₂, limiting mortgage interest rate deductions, simplifying child benefit regulations, and introducing the income-dependent tax credit. Fewer factors seemed to have played a role in the adoption of these individual reform measures. In the most extreme case (the income-dependent tax credit), inclusion in a –revised– government agreement proved sufficient for implementation. Many of the other factors, however, were found to indeed contribute and to have a varying influence on actual adoption, such as whether society is ready to accept a certain reform, and the topical preparations preceding the reform. In addition, an economic crisis may also create opportunities for reform.

In cases where a complete system reform is not be expedient, smaller scale reform measures could be proposed, in order to change the status quo. These smaller measures may contribute to society's readiness to accept and support any subsequent reform. Such a stepwise approach can be effective, and even more so in times of political fragmentation. However, a possible disadvantage of such a stepwise approach could be that certain reform proposals will never be adopted; for example because a lack of financial compensation would cause losses that are too big for specific groups.

Coalition agreement is the *window of opportunity* for tax reforms



1 Introduction

There are repeated calls for tax reform in the Netherlands; not only from scientists, but also from national and international institutes, political parties and official tax committees. The large amount of advice is impressive, often supported by sizeable reports stressing the positive impact on general welfare and the economy. Reform advice is primarily focused on content; on the problems, how these may be solved and the related effects.

Some of the recommended reforms are adopted, in full or partly, but quite often they are not, or not until years later. This begs the question of why certain measures or system reforms are not adopted when doing so would have clear advantages. And could the chance of them being adopted be influenced? The answers to these questions are relevant for policymakers who are in the midst of preparing proposals for such policy changes and would like to increase the likelihood of them being adopted.¹ The answers follow from a number of political and economic factors. Even small changes in the constellation of these factors already could determine a reform's success or failure.

¹ Starting point for such proposals is that they should raise general welfare, but, in actual practice, this is not always the case. Our analysis, however, focused purely on which factors do or do not contribute to the adoption of reform measures, irrespective of whether or not they would increase welfare.

This policy brief provides insight into the political-economic factors that would give tax reform measures a real chance of success. It does so according to a number of cases: the proposals for reforming labour and income taxes of 1990, 1991, 2001 and 2015, the conversion of the vehicle registration tax (VRT), mortgage interest rate deductions, and the streamlining of child benefit regulations² and the income-dependent tax credit (IDTC). These cases are described to illustrate the many economic and political factors that play a role in tax reform. The factors were selected according to the literature, particularly the OECD publications on the political-economic circumstances around structural reform.³ The cases are described, in further detail, in four background documents.⁴

Contemporary tax systems are complex. This is inherent to the multiple objectives of taxation, such as tax revenues being used in financing public goods and services and for redistribution. And then there are the tax measures that are designed to tempt citizens to behave in a certain way, or those that have certain undesired behavioural effects that need to be kept to a minimum. Furthermore, public support for the tax system and tax morale both benefit from a system that is widely viewed as being just. In addition, it is important for the system to be simple, feasible and transparent for tax payers as well as the tax department. Simultaneous achievement of the various objectives will not be possible; there will always be trade-offs between fairness, efficiency and simplicity. How they are weighted, however, may change over time, because of changing circumstances or preferences.

Periodical adjustments to the tax system are necessary, according to the Van Weeghel Committee (2010) – among other things, to give VAT a larger role in the taxation mix, to make VAT tariffs more uniform, and to reduce the number of tax deduction categories. In its interim report of 2012, the Van Dijkhuizen Committee suggested measures for making labour force participation more attractive, limiting the number of tax deduction categories and harmonising surcharges. The IMF (2016) recommends making the Dutch tax system more efficient by shifting tax on labour to tax on capital, including for example real estate taxation (OZB), and argues in favour of less favourable treatment of mortgages and business debts. In line with Lejour and Van 't Riet (2015), the IMF recommends a more uniform taxation of capital income and more uniform VAT tariffs, as also suggested by Bettendorf and Cnossen (2014). Furthermore, also the labour supply of women with young children could be increased, see the findings by Jongen et al. (2015).

There is a sufficient number of analyses available (among which that of CPB), as well as advice, to achieve another tax system reform – for the first time since 2001 – if so desired, combined with reforming the system of surcharges. Over the last years, a sizeable number of incremental adjustments have been adopted, some of which can be traced back to the above-mentioned studies by tax committees. For example, terminating salary savings and life course savings schemes, adjusting the special medical expenses deduction and the VRT, integrating and streamlining child benefit regulations, restricting deductibility of pension

² Child-benefit regulations consist of subsidies and fiscal compensation, particularly in the form of tax credits. Therefore, streamlining them was interpreted as a tax measure.

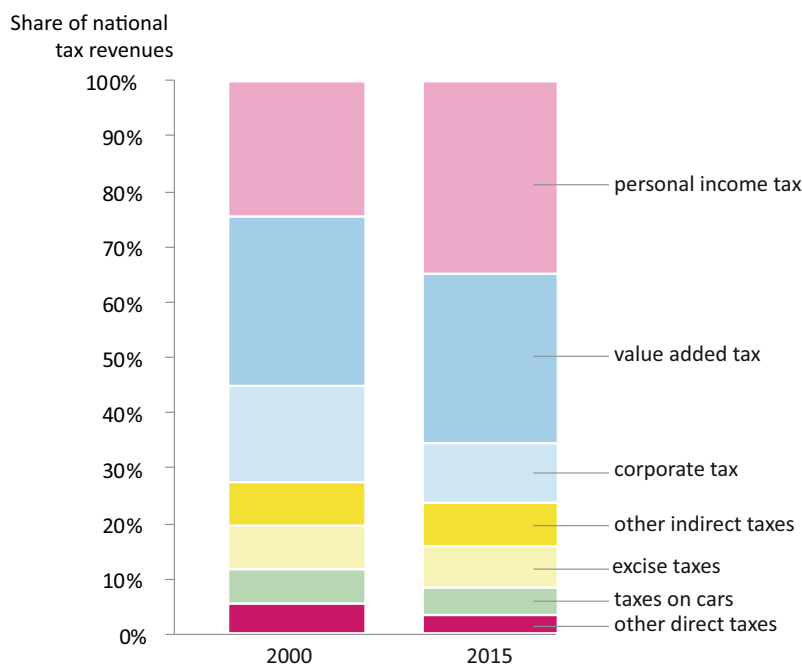
³ A number of these factors are also discussed in the *Mirrlees review*, see Alt et al. (2012).

⁴ Van Kempen and Suyker (2016) on tax reform, Lejour (2016) on mortgage interest rate deductions, Floor and Van 't Riet (2016) on VRT, and Jongen et al. (2016) on income policy.

premiums (the so-called Witteveenkader) and mortgage interest rate deductions, and making the flat rate in 'Box 3' progressive.

In practice, however, achieving an all-encompassing system reform that combines simplification with (shifts towards) a less fragmented and less disruptive mix of tax measures has proven difficult. The low VAT tariff has proved a sacred cow, and since 1 October 2012, only 1.5 billion of the 4 billion euros of the higher VAT tariff has been fed back into income tax. The share of VAT in total tax revenue was 30% in the year 2000, and this is still the case today, whereas the shares of wage and income tax have increased substantially.⁵ In contrast, the share of corporate income tax, part of the tax on capital income, has become much smaller. This is partly an economic effect (Figure 1.1). The share of the real estate tax OZB (a relatively less disruptive tax, on an immobile tax base) in total tax revenue was very limited in 2015, compared to many other countries (OECD, 2015).

Figure 1.1 Share of various taxes in total government revenue, in 2000 and 2015



This CPB Policy Brief describes why tax reform measures are adopted in some cases and not in others. Within this context, a successful reform is one that ultimately has been adopted, not necessarily one that is successful from an economic perspective. For our analysis, we studied a number of political-economic factors, using some explanatory theories from political science and political economy (see Section 2). We subsequently applied these factors and theories to a number of cases described in Section 3. In Section 4, the various cases are set against 10 political-economic factors, and conclusions are presented in Section 5.

⁵ In many EU Member States, direct taxes have been raised by more than the less disruptive indirect taxes, under pressure of increasing budget deficits. (EU, 2016).

2 Political-economic factors of tax reform

In much of the political-economic literature, the central proposition (Drazen, 2000) is that conflicts of interest may cause reform that would be beneficial to general welfare to not be adopted at all, or with a great deal of delay. The reason for this may be the fact that a negatively affected minority may have a large amount of political influence (e.g. due to a strong lobby). Reform abandonment can also be caused by uncertainty about the individual or joint benefits in combination with risk aversion.

It leads to status quo bias; after a reform measure has been implemented, it may prove to have led to more losers than was expected beforehand and the decision can be made to reverse the particular measure. However, when certain reform measures have not been adopted, it cannot be determined that there would have been more winners than initially expected. Information asymmetry between policymakers and electorate may explain postponement or abandonment; for example, because policymakers were unable to convince the electorate about the advantages of the reform (*communication failure models*), or there may have been doubts on the side of voters about the motives underlying the proposed reform measure (societal welfare versus party politics).

Various theories also have been developed from political sciences to explain the success or failure of reform proposals. One of those theories is the so-called three-flux model by Kingdon (2011). The model distinguishes between three fluxes in policy organisation: problem, solution and political will. The model explains why an issue has a chance of being placed on the policy agenda, and where problem, solutions and politics can meet; a policy window opens at a particular time and may help an issue to find its way onto the political agenda. This begs the question of which political and economic circumstances – positive or negative – could open such a window. Vis (2010) and Saint-Paul (2015) argue that, in good times, politicians are reluctant to take any electoral risk. However, under economically difficult circumstances they do, as at that point there are hardly any alternatives other than reform.

Over the last decade, the OECD has published multiple analyses of the political economy of reform. It identified a number of relevant factors, based on case studies (OECD, 2010). These can partly be traced back to the political-economic and governance theories discussed above. These factors support reform, although they do not all need to be in play, nor are they all equally important or have the same explanatory power. Moreover, some factors also affect others and, thus, the interactions between them can be complex. Based on the literature, a selection and interpretation was made of those factors relevant to the Dutch situation. These were subsequently grouped into three categories.⁶

⁶ The factor 'high quality institutes' used by the OECD was not included here, because it is mostly of importance for explaining international differences. The factor 'managing opponents' used by the OECD is largely covered by the factor 'support by societal organisations'. Brys (2011) also stresses the importance of timing, here translated into economic circumstances, and the role of packages of measures versus a stepwise approach. This last point was not explicitly included, because the cases already consist of separate or combined measures.

Support base

- **Electoral mandate.** Having an electoral mandate for reform is particularly important for general system or market reforms with many stakeholders involved. This was operationalised as: included in a government agreement. In the Netherlands, reform measures are seldom included in government agreements if they have not previously been mentioned in the election manifesto of at least one of the government coalition parties (see Suyker, 2013). In the Netherlands, the negotiation process around a government agreement is a typical policy window for large policy changes.
- **Stable national government.** This was operationalised as: a majority in the Senate and House of Representatives is in favour of reform. The OECD interpretation also includes the absence of signs of division among government parties. We did not include this last point, as it is difficult to measure.
- **Societal organisations.** If a reform proposal is supported by stakeholder organisations, this increases the likelihood of its adoption. Support among societal organisations was investigated by determining whether there was any positive advice by the Social and Economic Council (SER) and a positive response to the reform by stakeholder organisations.
- **Reform ripeness.** The proposed reform must be accepted within society at large, not just among smaller specific interest groups. The OECD mentions two specific characteristics for this acceptance: 1) a widely acknowledged view that current policy is failing, and 2) there have been previous attempts to apply incremental adjustments. Here, media attention can be helpful.
- **Economic crisis.** This concerns the perception, in politics as well as society, of there being an economic crisis making reform measures inevitable. This is in line with Vis (2010). Such a crisis may offer a *policy window of opportunity*. We made a distinction between this and reform readiness, because the desire to reform may also emerge in times of prosperity.

Preparations

- **Sound, independent research.** Research helps to determine whether a proposed reform really would increase welfare, and thus to find supporters for it, while convincing opposing parties of the need for reform and of its positive effects. In addition, an ex-post evaluation, or its announcement, may increase the support for (further) tax reform, because this would provide the opportunity for correction. On the other hand, transparency about the effects may also mobilise the losers.
- **Sound policy preparation.** The most successful reforms, according to the OECD, are preceded by at least two years of preparation, not including any exploratory work, before a concrete plan is completed. Policy preparation is subsequently operationalised by considering the preparation time.

Communication and more

- **Political leadership.** According to the OECD, leadership is about 'ownership' of the reform. Leadership is a difficult concept to operationalise; here, leadership scored positively when more than one of the interviewees mentioned it as a relevant factor.

However, after a reform proposal fails, it is unlikely that a lack of political leadership will be identified as a factor in the failure.

- **Effective communication** means that both voters and stakeholders have been made aware of the need for reform, including the related costs of having no reform. Effective communication may help to open a policy window. This concerns not only the necessity in the short term, but also the long-term objective of reform.
- **Financial compensation** can help to cushion the negative impact of reform (e.g. on income) for certain groups in society. The availability of such trade-offs may, in fact, open a policy window.

A number of factors will create preconditions and require persistence, repetition and patience (e.g. in conducting research, policy preparation, mobilising support, and ensuring reform readiness), while other factors contribute to opening a policy window within a short time-period. This second group of factors, for example, includes the negotiations on a government agreement and the state of the economy, a crisis that makes reform necessary or adds an argument in favour of it, or financial windfall that may serve as a financial compensation.

3 Case descriptions

Wage and income tax reform

In the mid 1980s, the Dutch tax system was regarded as complex and susceptible to tax evasion. Moreover, consensus was that the highest tax rate was too high, from an international perspective. The Lubbers I Cabinet had the system investigated. By the end of May 1986, the Oort Committee published its findings.⁷ Its proposals were supplemented by those from the Lubbers II Cabinet and found their way into several bills. In February 1989, the Dutch House of Representatives passed these bills, followed by the Senate. The bills, which became law per 1 January 1990, included reducing the number of tax brackets from nine to three, integrating social insurance premium payments in income tax, lowering the highest tax rate (from 72% to 60%), and limiting the deductibility of ‘mixed costs’⁸.

In March 1990, the Stevens Committee was installed as a follow-up to the Oort Committee. In July of the following year, their report was published, titled *Graag of niet* (‘take it or leave it’), which included a package of interrelated measures. Proposals included, for example, to reduce the number of tax brackets from three to two, increase taxes on the notional rental value of property, and abolish tax deductions for a number of employees’ social insurance premiums. The report met with a mixed response. The Lubbers III Cabinet asked the SER for advice, which subsequently issued a critical advice rejecting adoption of the proposals. This rejection brought a definite end to the reform, which had not been included in the government agreement.

⁷ Committee to simplify wage and income tax (Oort Committee), 1986, *Zicht op Eenvoud* (‘View on Simplicity’)

⁸ Both private and business costs.

A new step towards system reform was taken in 1997, with the outlook document titled *Belastingen in de 21^e eeuw* ('taxation in the 21st century'), issued by the Kok I Cabinet. The document included outlines for a tax system in which labour and capital incomes were taxed differently. Following a positive SER advice, the outlines were drafted into bills that were submitted by the Kok II Cabinet in the autumn of 1999. The legislative process that followed was tight, at least according to the opposition. Early 2000, the House of Representative agreed on the proposed tax reform and, in May, so did the Senate. In 2001 the reform measures were implemented; the synthetic system was replaced with an analytical system of 'boxes'. Capital gains tax in Box 3 was implemented, and tax-free amounts were replaced with tax credits. The changes also involved an increase in the general VAT tariff.

A more recent attempt at tax reform can be traced back to the Van Weeghel Committee established in 2009 by the Balkenende IV Cabinet. This committee, among other things, advised to increase the VAT share in tax revenues, uniformity in VAT tariffs, and reducing the number of tax deductions. One year later, the Dijkgraaf motion led to the formation of the Van Dijkhuizen tax committee. In its interim report, this committee proposed measures to encourage labour force participation. Elements of that proposal were included in the government agreement of the Rutte II Cabinet, partly because they were also in the election manifestos of the coalition parties. In September 2014, in his letter to the House of Representative, State Secretary of Finance Wiebes proposed to conduct a general system reform. One year later, his proposal was concretized in a 5-billion-euro package of measures to reduce financial burden. He also suggested the possibility to shift a part of the income tax toward the VAT and real-estate taxation (OZB). However, confidential negotiations with opposition parties failed, after which only the reduction in financial burden and the reform of the capital gains tax in Box 3 was implemented.⁹

Mortgage interest rate deductions

The amount in paid mortgage interest grew from 3% of GDP in 1991 to 5.4% in 2009. As a result of this increase, the losses in tax revenues from Box 1 were close to 11 billion euros in 2014, taking into account the notional rental value of property. In addition to the effect of the mortgage interest rate deductions (MID) on the government budget, this also distorted the choice between renting a house and homeownership. It furthermore also drove up house prices the size of mortgages, and influenced income distribution.

Since the beginning of this century, various reports had been warning against these effects, but they were never addressed. However, with the economic crisis and the drop in house prices, the size of the mortgage debt was regarded as a threat to economic stability as well as the issue of many households facing the problem of their homes being 'underwater'. Therefore, in the 2012 budget agreement and the formation of the Rutte II Cabinet, substantial steps forward were made: from then on, new mortgages had to be paid off in level payments within 30 years, and the maximum deduction rate was to be lowered, over 28 years, from 52% to 38%.

⁹ Because of its topicality, the case of reduction in financial burden of 2015 was added. There is the possibility that, a few years from today, certain circumstances may be regarded in a different light.

Greening vehicle registration tax (VRT)

The tax on passenger vehicle purchases, the VRT, was reformed in 2009, from being based on a car's list price to the amount of CO₂ that its engine would emit. This with the intention to encourage buyers to choose more fuel-efficient vehicles that would contribute to CO₂ emission reductions. In 2009, a VRT exemption was implemented for very fuel-efficient cars, while the tax based on list prices was gradually replaced with a tax based on a vehicle's CO₂ emission level. The fiscal encouragement to buy more fuel-efficient vehicles had a sizeable negative impact on tax revenues. From July 2012 onwards, efforts were made to close this budgetary gap.

Simplification of child benefit regulations

In 2015, child benefit regulations were drastically simplified with a reduction in the number of subsidies from 11 to 4. Up to that point, there had been a hotchpotch of subsidies, with certain ones intended to counterbalance particular effects of others.¹⁰ In the Brede Heroverwegingen 2010, child benefit subsidies were addressed integrally, for the first time, leading to concrete reform analyses. A subsequent proposal was further elaborated by the Rutte I Cabinet and later included in the Rutte II government agreement. Ultimately, these subsidies were officially simplified per 1 January 2015.

Income-dependent tax credit

During the most recent government formation negotiations, one important issue for the PvdA (Dutch labour party) was that higher incomes would contribute more than lower incomes to the improvement in public finances. The income-dependent healthcare premium as proposed in the government agreement, however, was unacceptable to the support base of coalition party VVD (Dutch conservative liberal party). After intense political discussion and without policy preparation, the government agreement was amended by gradually reducing tax credit in the second and third tax bracket. This last-minute decision-making, in the autumn of 2012, led to additional implementation costs for the tax authorities, as well as to tax reassessments for millions of citizens and to an increase in the system's complexity.

¹⁰ An example would be the supplementary single-parent tax credit, which were only intended to encourage single parents to participate, despite this financial addition to the welfare benefit for single parents.

4 The problem, its circumstances and solutions

A number of the political-economic factors described in Section 2 played a role in all of the cases. These factors are systematically discussed in this chapter.

Electoral mandate: formalised in government agreement

In the Netherlands, cabinet formations provide important policy windows for the adoption of reform. It is hardly imaginable that general system reforms are implemented without having been formalised in a government agreement. The system reforms of 1990 and 2001 were included in the government agreements of Lubbers II and Kok II. A reform of child benefit regulations was also formalised in various government agreements, and the income-dependent tax credit were a de facto amendment to a government agreement. In a number of cases, reforms were also supported by opposition parties. For example, the Cramer motion, among other things calling for reform of the vehicle registration tax (VRT), was supported by opposition parties SP, GroenLinks, D66, SGP and PvdA. Restrictions to the mortgage interest rate deductions for new cases, with mandatory repayment of the principal mortgage amount, were included in the budgetary agreement between VVD, CDA, GroenLinks, D66 and ChristenUnie. The notion of crisis (to comply with EU budgetary standards) and the withdrawal of the PVV as party supporting the coalition, provided a window of opportunity for a new political agreement. The restrictions on interest rate deductions was subsequently formalised in the government agreement of the Rutte II Cabinet.

The reform proposals of 1991 and 2015 were not included in government agreements. This would support the conclusion that inclusion in a government agreement is a precondition for the adoption of reform proposals. Furthermore, it seems that any subject needs to be high up on the political agenda, well before election time, for it to be included in a government agreement. Suyker (2013), for example, shows that the same issues that are part of a government agreement almost always also feature in the political parties' election manifestos.

Stable national government: Cabinet has majority in both Senate and House of Representatives

For any cabinet to be able to amend laws, it needs a majority in both Senate and House of Representatives. In the reality of Dutch Government, this means that government coalition parties need a majority in both, as these are the parties that would normally support government policy. Until recently, this was normal practice in Dutch parliamentary history. However, over the last years this has changed. The Rutte II Cabinet needed the support of the opposition in the Senate, in order to achieve a majority

However, having achieved such a majority does not mean that reform will always be adopted. This became apparent from the attempted reform of 1991. However, the opposite is also true: not having a majority in both Houses is not a determining factor either. After all, even without such a majority coalition, mortgage interest rate deductions became limited, child benefit regulations were streamlined and the general tax credit became income-

dependent. All this, incidentally, does not mean that a political majority reached through the support of other parties is easy to achieve. The lack of a political majority in the Senate indeed played a role in the failed attempt at tax reform in 2015.

Support among stakeholder organisations

In the Netherlands, many new policies are drafted during a process of consensus decision-making together with stakeholder organisations, the so-called polder model. The most visible are the cabinet requests for SER advice. The Rutte II Cabinet has also involved societal organisations in the policy preparation process, in order to achieve support within society.¹¹ However, does such support have an actual effect on the likelihood of reform being implemented? For the system reforms of 1990 and 2001, the employers' organisations and trade unions in the SER supported the reforms' main elements. The 1991 reform clearly lacked such support, as was also the case in 2015. The employers' organisation wanted a reduction in the financial burden, but for instance no increase in VAT. The reduction in financial burden did come to pass.

For years, a restriction of mortgage interest rate deductions met with resistance from various organisations, such as Vereniging Eigen Huis (homeownership association), the NVM (real-estate association), Bouwend Nederland (construction companies) and the banks. Over the years, partly under pressure of the crisis and numerous reports, thinking on the subject became reversed. This resulted in 'Wonen 4.0' (on housing).¹² Thus, support can be said to increase the likelihood of reform being adopted. It is, however, not crucial. The automobile industry and environmental organisations, at first, were not in support of the greening of the VRT, but it nevertheless passed. And reforms of the income-dependent tax credit and child benefit regulations were adopted without there being any clear support among stakeholder organisations.

Reform ripeness

Tax reform measures have a greater chance of being adopted if their necessity is also felt within society. Society must be willing to abandon the status quo, which can be fuelled by positive reports or advice on the subject. For example, the tax reforms of 1990 and 2001 were preceded by a widely shared belief that the system needed to be modernised. Well before the 2001 reform, many already were convinced that the tax base (related to capital) was being further eroded and that tax rates had to be further decreased.

For the 1991 system reform proposal, which ultimately was not adopted, there was no willingness to reform. In 1991, there rather was reform fatigue, after the system reform of 1990. In 2015, the need was felt for reducing the financial burden and there was little support for raising the lowered VAT tariffs, or for increasing the real estate tax. In addition, substantial fiscal changes had already been implemented by the Rutte II Cabinet, such as the restrictions on pension-related tax benefits (Witteveenkader) and mortgage interest rate deductions.

¹¹ Examples are the social agreement, housing agreement, agreement on decentralisation of long-term care and social support, and the agreements about reforming pensions, long-term care and the student loan system.

¹² This concerns the joint vision of the markets for rental housing and owned housing, of NVM, Aedes, Vereniging Eigen Huis and Woonbond.

The fact that willingness to reform plays a role, is apparent from earlier, limited, adjustments to the tax system. An example would be the so-called *bijleenregeling* – limiting interest deductibility on additional borrowing, with respect to mortgage interest rate deductions. For the VRT reform, a no-claim bonus system had already been implemented. In addition, there was broad consensus on the need to reduce CO₂ emissions and on the automobile industry and the transport sector also having to contribute to this objective. In short, in all of the investigated cases, reform readiness was found to be important to reform adoption.

Economic crisis

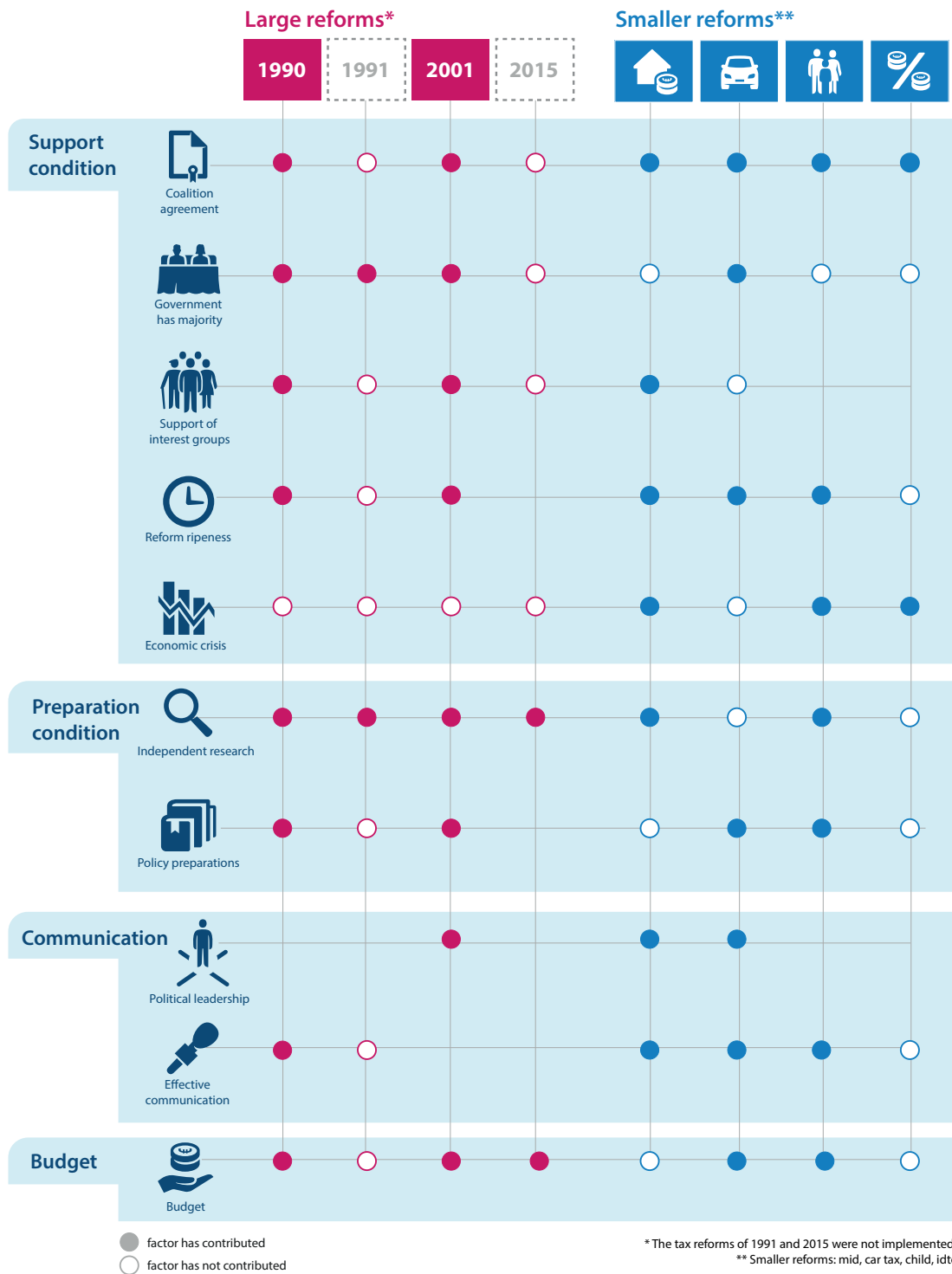
For a number of specific reforms, the bad economic and financial situation was reason for taking action (*never waste a good crisis*). The income-dependent tax credit and streamlining of child benefit regulations both generated some budgetary room. The restrictions on mortgage interest rate deductions were partly inspired by a tight budget and by the threat of a large EMU deficit. The serious government deficit and the crisis both created the opportunity for reforming the housing market. This had not been possible before. Surveys of the population, held over the course of the crisis, also showed a growing understanding for limiting tax deductions.

Sound, independent research

This concerns research on reform subjects by independent national and international institutes or committees, already available at the time of policy preparation. The proposals for sizeable system reforms, for example, were prepared by tax committees. Such research seems a necessary precondition for large interventions in the tax system. Without those reports, it seems unlikely that those tax reforms would have been included in a government agreement.

This also applied to mortgage interest rate deductions and child benefit regulations, but not to greening of the VRT or to income-dependent tax credit. This last reform only made it into the Rutte II government agreement because of the political pressure to rapidly find an alternative for the income-dependent healthcare premium. Greening of the vehicle registration tax (VRT) was not investigated until after the plans had already been included in the government agreement. This shows that independent research is not always necessary for a measure to be implemented, although it cannot be ruled out that early availability of independent research would have changed the measure in some way.

Which factors do contribute to implementing a reform?



Sound policy preparations

Sound policy preparations in the run up to a legislative process and reform implementation may help to underpin and present the reform. This may also be useful in finding support for the proposal. The recurring and successful pattern, for large system reforms such as those of 1990 and 2001, is that of exploration and research during one cabinet term, followed by legislation being passed in the subsequent cabinet term. It is also effective if the technical aspects of implementation are prepared beforehand. And, if the same coalition that has prepared the reform stays on for another term, this is also beneficial to the adoption process.

There had been less elaborate and shorter preparations for the system reform proposals of 1991 and 2015. In 1991, the cabinet did ask the SER for advice, but it did not take a position itself. In 2015, the actual proposal was presented within a relatively short time, in the form of a 'menu' offering various choices. Such a short preparation time does not benefit the likelihood of reform being adopted.

However, preparation time does not seem to be a determining factor for partial system reform. The restriction of mortgage interest rate deductions and income-dependent tax credits were both adopted without a great deal of preparation beforehand. The VRT reform, on the other hand, had a policy preparation time of over two years, and those for streamlining the child benefit regulations took as much as four years.

Political leadership

The literature identifies 'ownership' of the reform as political leadership. For the system reform of 2001, the restrictions on mortgage interest rate deductions, and the VRT reform, political leadership by relevant cabinet members was mentioned explicitly as a factor that supported implementation. This factor was not mentioned in any of the other cases – which does not necessarily mean that leadership was irrelevant, but that it was not visible at least. It could have been that the reform already had so much political and public support that political leadership was not necessary, such as for the system reform of 1990.

Effective communication (framing)

In order to push a reform proposal along, its importance must be properly communicated, or framed. The restrictions on mortgage interest rate deductions were mostly communicated as a way to counter high mortgage debt and to prevent new 'underwater' issues. The crisis enabled such framing, while available research reports were arguing the possible efficiency benefits and redistribution aspects of the reform measures. The framing of the VRT reform as an option for achieving environmental gains without additional financial burden seems to have contributed to its successful implementation. The Oort operation in 1990 presented the tax reform mostly as a necessary simplification that would be to everyone's benefit.

The Stevens Committee argued in 1991 in favour of a complete overhaul of the tax system. This explains the title of the report 'Take it, or leave it' (Graag of niet). This particular framing appeared to work as a barrier; policymakers would rather draft reform measures themselves from the number of proposed measures. The tax reform of 2001 was presented

as ‘the robust system for the 21st century’. Those interviewed as well as others doubted whether this was very effective, but it also did not hinder adoption of the reform. The 2015 reform proposal was not framed as a package of measures that had to be implemented as a whole, but rather consisted of a menu of measures to choose from. In the end, only the reduction in financial burden related to income tax was implemented. Fundamental elements (transferring the financial burden to VAT and OZB) were not adopted.

Compensation

Tax reform generally has both winners and losers, in terms of purchasing power or employment. If budgets allow losers to be compensated, this will lower any resistance against the reform. For the system reforms of 1990, 2001 and 2015, respective financial compensation of 2, 2.5 and 5 billion euros was indeed available. A rapid improvement in government budget was in fact the reason for proposing the tax reforms.

In 1991, there was no room for financial compensation, although this fact does not seem to have been the decisive reason for the reform proposal’s failure. This was rather due to a lack of support. In case of the VRT reform, the budget was sufficient to compensate for the lower revenues caused by behavioural effects, although the eventual magnitude of these losses was unforeseen. The fact that there were no financial compensation available for the reform of mortgage interest rate deductions and the income-dependent tax credits did not stand in the way of these reform measures being adopted.

5 Lessons

From an economic perspective, tax reform is assessed on its general welfare impact. This may concern efficiency, level of redistribution, the generated revenues, complexity in its implementation or degree of fairness, but may also be related to environmental quality or the impact on human health. However, even if the reform is expected to contribute positively to general welfare, this does not mean that it will automatically be adopted, as this also depends on certain political-economic circumstances.

In this study, lessons have been drawn from earlier reforms and attempted reforms, with the central focus on the factors that determine whether a reform is likely to be adopted. A large number of tax system reforms and reform measures were studied. We found that major reforms have a good chance of being adopted if the reform is included in a government agreement, there is sufficient public support and careful preparation. This has been shown in independent research and several years of policy preparation. Also important factors are a political majority in both the Senate and House of Representatives, reform readiness, and sufficient budget to compensate any losers in the reform. Other factors, such as political leadership and effective framing, can be helpful, but do not determine whether reform measures will be adopted and implemented.

Certain circumstances clearly contributed to the failure of the reform proposals of 1991 and 2015, while others were unable to increase their chance of success. A lack of public support seemed a particular reason for both failures. In both cases, in-depth preliminary research had been conducted before the start of the reform process. Thus, although such research may increase the likelihood of reform being adopted, it appears not to be a determining factor.

For individual reform measures, fewer factors were found to be important. In the most extreme case (income-dependent tax credit), the inclusion in the government agreement proved to have been sufficient for adoption of the reform. Many other factors did help, though. All cases did for example have a certain degree of support. And the economic crisis also increased the sense of urgency for the reform. Furthermore, we found that a certain amount of preparation, in the form of independent reports or policy preparation, is necessary. In most cases, effective communication was found to contribute to adoption of the reform and, in some cases, political leadership also helped the process along.

Preparation and communication about the reform can, to a certain degree, both be influenced by Cabinet. This is much more difficult, however, for public and political support, certainly in the short term. And yet, these are vital points for any reform to succeed. In addition, also sufficient budget is important, as additional funds may help to secure enough support.

The attempts at reform, in 1991 and 2015, were not completely pointless, as a number of measures from the reports by the Stevens, Van Weeghel and Van Dijkhuizen committees were implemented at a later date.

If complete system reforms are not expedient, sometimes smaller scale reform can be proposed, if only to break the status quo (Brys, 2011). Such smaller scale reforms may contribute to the willingness to reform, thus, provide support for a subsequent reform. Moreover, individual reform measures have a greater chance of their results becoming visible during the same cabinet period. This may increase political support.

In times of political fragmentation, a stepwise approach may be a good alternative. Although this type of approach does have the disadvantage of certain reform measures never being implemented; for example, because of a lack of compensation would cause losses that are too great for certain groups. In these cases, it can be difficult to abolish tax deductions. Precisely for that reason, the Mirrlees review (Alt et al. 2012) recommends combining the reforms of various taxes in order to create possibilities to compensate.

Conclusion

Being included in a government agreement has been shown to be the ultimately decisive factor in successful reform. Once such an agreement has been finalised, the policy window more or less closes, until the next elections. Before they are included in a government agreement, reform proposals generally are part of the election manifesto of one or more political parties, whereby both reforms and available solutions need to be sufficiently clear, beforehand. The strategy for ensuring that the reform is placed on the political agenda, is to have the subject extensively investigated, early on, and to draw up a communication plan for creating sufficient support. Only then, solutions will already be on hand when the opportunity for reform presents itself, and public support will be in place.

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