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Financing Security Through Elite Taxation: The Case of Colombia's "Democratic Security Taxes"

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Abstract Governments across the developing world in general, and Latin America in particular, tend to have difficulty in raising taxes among elites. Beginning in 2002, however, the Colombian government adopted a series of wealth taxes among the wealthiest taxpayers. Revenue from the tax was earmarked for security expenditures and represented about 1 % of GDP. Drawing on elite interviews, surveys, government documents, and media sources, this article studies the factors behind the adoption of the tax. It finds that three main factors make the elite tax possible, namely the combination of fiscal and security crises, cohesion among business and government elites, and improving perceptions of the government's provision of public safety. The findings should inform efforts in the developing world, where low levels of fiscal extraction, deteriorating security conditions, and mounting public safety expenditures are common.

Keywords Latin America · Business-government relations · Taxation · Elites · Crisis · Security · Colombia

Latin-American elites have historically been in a good position to resist taxation (Kaufman and Stallings 1991; p. 19). This has contributed to the region's relatively low levels of taxation vis-à-vis developed countries (Bird 1992). Most Latin-American countries collect in taxes between 14 and 18 % of GDP, which is considerably lower than most European countries' share in the upper 20s or some Scandinavian countries in the 50s (IMF 2011).[1] These low levels of taxation have impaired governments' ability to provide public safety, deliver health and education services, alleviate poverty, and uphold the rule of law (Moore 2007). The incapacity to deliver these goods undermines the quality of democracy across the region and becomes particularly damaging in societies experiencing internal conflict.

[1]Brazil's tax revenue/GDP in the mid to upper 20s is an exception in the region.

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In this context, the rare cases in which government and elites reach a consensus to collect additional taxes are worth studying. One such case is Colombia's adoption of a wealth tax to finance its security effort against drug trafficking, guerrilla, and paramilitary groups. During Álvaro Uribe's presidency (2002–2010), the government collected a security tax on the wealthiest taxpayers, which was earmarked for defense and security expenditures.[2] Dubbed the "Democratic Security Tax" (*Impuesto de la Seguridad Democrática*), its contribution has been significant in funding the country's security effort. It has accounted for about 20 % of the defense and security sector's total budget and has been mostly allocated toward investment, allowing for a 120 % increase in this sector's investment expenditures. The tax has accounted for about 5 % of tax revenue or about 1 % of the country's GDP.

While governments in developing countries often fail to compel the wealthiest sectors of society to pay taxes, how was the Colombian government able to levy a tax borne by the wealthiest Colombians? The adoption of the tax is particularly puzzling, given that the inability to tax elites has been at the heart of the failure of previous reform attempts in Colombia.[3] As Richard Bird has noted (1992; p. 27), this country "has certainly not been able to overcome the fundamental problem bedeviling direct tax administration in most of Latin America: the political impossibility of enforcing taxes on rich and powerful taxpayers." In the words of Miguel Urrutia (1989; p. 24), "economic groups in Colombia [...] often seem to be able to block in Congress or within the parties government measures that clearly harm them." In light of these considerations, the adoption of the security tax should be no different given the right-of-center orientation of Uribe's government and the cohesion that characterizes Colombian elites (Schneider 2004; p. 18), factors that have been associated with difficulty in taxing the wealthy (Fairfield 2010).

This article explains the conditions that made possible the adoption and subsequent renewal of a security tax on economic elites in Colombia. In doing so, it seeks to answer the following questions. What factors contributed to the implementation of Uribe's four security taxes? What were the different stakeholders' positions on the tax? What were the alternative courses of action evaluated by the government? What was the nature of the bargain between taxpayers and the government? How were the resources spent and what impact did they have? What lessons does the Colombian experience offer to understand the prospects for extracting revenue from elites elsewhere?

Drawing on evidence from elite interviews, surveys, government documents, and media sources, the study finds that three main factors make the adoption of the security tax possible. Initially, the country's fiscal and security conditions prompted the government to declare a state of emergency to adopt the tax by decree. Moreover, elite cohesion among government and business sectors contributed to generating a consensus behind the tax through cooperation mechanisms and linkages between government and business. Finally, improving perceptions of the government's ability to provide security further defused opposition.

The article is organized as follows. First, I present an overview of the country's Democratic Security Taxes and their significance for the security effort. Second, I

[2] The tax continued during President Santos's administration.

[3] A detailed account of failed attempts at taxing elites is not included because of space considerations, but for a discussion of a dozen attempts since 1974, see Urrutia 1989; Harberger 2002; Olivera, Pachón, and Perry 2010.

review the literature on elite taxation and identify different theories' expectations. Third, I discuss whether and how the expected dynamics played out in the adoption of the security tax. In the last section, I conclude with the findings' significance for theory and policy and implications beyond the Colombian case.

Colombia's Democratic Security Taxes

President Uribe adopted a wealth tax in 2002 aimed at the wealthiest taxpayers—those whose assets surpassed COP$169.5 million (US$65,000)[4]—and set for 1.2 % over individuals' and corporations' liquid assets.[5] About 420,000 taxpayers were required to pay the tax, or about 1 % of the population. Of these, an estimated 120,000 were corporations and 300,000 were individuals. Exempt from paying the tax were foundations and nonprofit organizations, departments, municipalities, and indigenous reservations (*resguardos indígenas*), unions, and parent–teacher associations, among others.

In December 2003, the Colombian Congress approved a second tax for the 2004–2006 period on assets surpassing COP$3,000 million (US$1 million). Three years later, in December 2006, Congress established a third security tax for 2007–2010.[6] In December 2009, as Uribe's presidency was coming to an end, Congress adopted another tax for the 2011–2014 period. These subsequent taxes targeted a more narrow, wealthier base of about 33,000 Colombians with at least COP$3,000 million in liquid assets. Table 1 summarizes the main features of Colombia's Democratic Security Taxes.

The Democratic Security Taxes added considerably to the government's coffers. When the tax was first adopted, it covered a gap of COP$2 billion (US$797 million)—about 5 % of total government revenue or 1 % of the country's GDP. Since then, the tax revenue as a share of the government's total has fluctuated between 2.5 and 5 % (Dirección de Impuestos y Aduanas Nacionales 2011). The revenue from the security taxes was also significant for the armed forces. It represented 20 % of the defense and security budget, including the armed forces, national police, and intelligence services.

During the first 4 years of Uribe's presidency, these resources funded an increase in the size and professionalization of the military (interview with Ramírez 2010; Ministerio de Defensa Nacional 2009). In addition to the procurement of fuel and food rations and maintenance of equipment, the funds allowed the armed forces personnel to grow by more than 100,000. They created 2 divisions, 18 brigades, 15 battalions, 13 urban antiterrorist units, and 598 town guard (*Soldados de mi Pueblo*) platoons, among other units (Ministerio de Defensa Nacional 2009). As a result, armed forces personnel increased by about 36 % and combat forces by 45 % during Uribe's first term in office (Vargas and García 2008; p. 46). This objective was at the core of the government's plan—dubbed Democratic Security Plan—to expand its presence across the territory. During Uribe's second term, these resources allowed the armed forces to increase capital expenditures (interview with Giha 2011). In

[4] All dollar figures are nominal and were converted using the average yearly representative exchange rate figures from Colombia's Central Bank (Banco de la República).

[5] I.e., gross assets minus debt. The calculation of wealth included real estate, vehicles, cattle, ranches, banks accounts, factories, plants, and equipment.

[6] The calculation of wealth excluded the first COP$200 million (US$117,000) of main residence (home or apartment), as well as the net value of stock in domestic companies.

Table 1 Colombia's Democratic Security Taxes, 2002–2009

Year approved	Tax	Duration	General objective	Expenditures
2002	1.2 % of total liquid assets over COP$169.5 million (US$65,000) as of August 31, 2002.	1 year (2002)	Expansion of state presence	Financed fuel, food rations, and the increase and professionalization of the armed forces personnel
2003	0.3 % of total liquid assets over COP$3,000 million (US$1 million) as of Jan. 1, 2004	3 years (2004–2006)	Continuation of the effort to expand state presence in the context of the Democratic Security Plan	Increased armed forces personnel by 36.3 % and soldiers by 45 % between 2002 and 2006[a]
2006	1.2 % of total liquid assets over COP$3,000 million (US$1.3 million) as of Jan. 1, 2007	4 years (2007–2010)	Consolidation of Democratic Security; improving mobility, intelligence, and manpower (pie de fuerza)	Purchased equipment including weapons, airplanes, helicopters, submarines, and frigates
2009	2.4 % of total liquid assets above COP$3000 million (US$1.4 million) and 4.8 % of total liquid assets above COP$5,000 million (US$2.3 million), as of Jan. 1, 2011[b]	4 years (2011–2014)	Consolidation of Democratic Security; alleviate natural disasters	Increased armed forces and disaster relief

[a] For a detailed account of the expansion and modernization of the armed forces see Schultze-Kraft forthcoming

[b] Decree 4825 of Dec. 29, 2010 created two additional tiers: 1 % of liquid assets between COP$1,000 million and COP$2,000 million, and 1.4 % of liquid assets between COP$2,000 million and COP$3,000 million. The decree also mandated a 25 % surcharge for those in the two original tiers

particular, between 2007 and 2010, the tax raised COP$7.54 billion (US$3.9 billion), which contributed to the purchase of weapons, airplanes, helicopters, submarines, and frigates (Ministerio de Defensa Nacional 2009; p. 26).

In the absence of the security tax, the government was severely constrained in carrying out these goals. Before the tax was adopted, about 92 % of the yearly defense budget was committed beforehand to cover ongoing operating expenses including wages, pensions, and fuel. Only 8 % of the funds could be invested in increasing the number of troops or acquiring new equipment (DNP 2007). As a result of the security tax, investment expenditures more than doubled (interviews with Jiménez 2010 and Ortiz 2010).

The security tax also assisted in filling the gap left by decreasing resources received from Plan Colombia (interview with Jaramillo 2010)—the multi-year assistance plan by the United States secured by President Pastrana. By 2010, the last year of Uribe's presidency, Plan Colombia contributed COP$0.6 billion (US$316 million) to the armed forces, about a third of the funds received in 2000 (Haugaard et al. 2011; p. 5). In 2010, revenue from the security tax represented about four times Plan Colombia's military funds. By compensating for the loss of resources in foreign assistance, the security tax played a key role in preserving the government's room for maneuver (interview with Giha 2011).

Theories of Elite Taxation

The literature on tax reform in general and the scant literature on elite taxation in particular point to several factors that may explain the adoption of the security taxes on the wealthy in Colombia. In this section, I introduce three main explanations and discuss the theoretical expectations that stem from them. In the following section, I will show how they account for the security taxes.

Crisis as Impetus for Taxation

One of the most frequently invoked explanations for tax reforms points to the occurrence of crises or major shocks to the polity as the impetus for extracting greater levels of resources from society (Bird 1992; Weyland 1996; Mahon 2004; Sanchez 2006; Fairfield 2011). Grounded in the economic reforms literature of the 1980s and 1990s, this explanation argues that whenever a situation is perceived as unsustainable, society becomes willing to “swallow the bitter pill” and accept certain policies previously deemed as unacceptable (Weyland 1996). As Bird (1992; p. 22) has suggested, “When the choice is as stark as ‘adapt or cease to exist,’ the fundamental societal instinct for survival might force almost any country to adopt reforms necessary to avoid extinction.” The same logic has been applied to elites. In this view, only severe threats compel economic elites to accept higher taxes because they believe “someone else can be forced to bear the burden” (Drazen and Grilli 1993; p. 598). As Slater (2010; p. 13) has pointed out in the Southeast Asian context, “Given their propensity for parochialism, elites will not deemphasize their narrow factional interests on behalf of broader class interests except under extreme duress.”

Latin America is no exception to this pattern. Governments' ability to carry out tax reforms in the face of elite opposition has been associated with crises—from drastic economic conditions, to conflict, to natural disasters. For example, in seminal articles on the determinants of tax reform in Latin America, Mahon Jr. (2004) points to high levels of inflation and Bird (1992; p. 10) to economic downturns as key determinants of tax increases. Centeno (2003) suggests that conflict forces otherwise unwilling elites to contribute resources to governments' coffers. More recently, Fairfield (2011) has shown how the 2010 earthquake in Chile played a major role behind the adoption of extraordinary taxes by the business-friendly government of Sebastian Piñera.

One difficulty in following a crisis-based explanation is the question of how to identify ex-ante a crisis that is severe enough to trigger reforms. As Corrales (1997–98; pp. 617–18) has noted, the role of crises is hard to predict, and it is unclear what constitutes "'the real' crisis. […] Wars, invasions, natural disasters, crass human mistakes, economic collapse, and political disasters are all likely candidates." Responding to this issue, Slater (2010; p. 14) proposes a benchmark based on the type of crisis. Those perceived as endemic or unmanageable are likely to elicit elite collective action, whereas those perceived as contained or temporary are not. Although the line between the two may remain blurry and borderline cases may be hard to classify, Slater's benchmark provides a useful first step in identifying the type of shock that may prompt elites to accept higher levels of taxation.

In light of these theoretical considerations, this view would expect higher levels of extraction among elites to be a product of a situation that severely jeopardizes economic elites' livelihood and/or the national government's ability to function. Additionally, the situation must be perceived as having escaped the reach of conventional policymaking alternatives. Armed conflict, hyperinflation, and fiscal collapses are cases in point.

Business–Government Relations

A second possible explanation for elite taxation focuses on elite cohesion—the ties among business and government elites that compel them to pursue common goals. There are two main views under this heading. The first one argues that elite cohesion is conducive to measures that tax the wealthy more heavily. For example, Weyland argues that cohesion lengthened Chilean business elites' time horizons, even in the presence of a left of center government, and allowed them to focus on longer term developmental goals that tend to require progressive taxation (1997). Similarly, in a study of Brazil and South Africa, Lieberman (2003) suggests that the lack of cohesion among elites in the Latin American country negatively affected business sectors' willingness to contribute towards financing public goods, whereas cohesive elites in the African country were willing to bear additional taxes.

The second and more recent view has identified the opposite effect; elite cohesion defuses governments' efforts to extract fiscal resources from business sectors. For example, Fairfield (2010) finds that elite cohesion helped preclude progressive tax increases in Chile while the lack of cohesion allowed greater reforms to be passed in Argentina. Similarly, Prichard and Hassan (2012) point to elite cohesion as conducive to the state capture in Bangladesh, which results in a lighter tax burden for economic elites.

Both perspectives identify similar mechanisms as responsible for their preferred effects, including the establishment of linkages with key decision makers, consultation forums, and collaboration mechanisms. The first view expects these mechanisms to foster the exchange of information reflecting the different actors' needs and capabilities and to lengthen the different actors' time horizons, which in turn are expected to undermine elites' resistance to higher taxes. In other words, it expects these mechanisms to elicit a better understanding of the government's need to extract additional resources among business elites. The second view points to these mechanisms as playing a key role in making business elites' views clear and pressing the government to follow them (Fairfield 2010; pp. 38–39). In particular, they increase the effectiveness of lobbying, give business elites continuous opportunity to voice their concerns, and encourage the formation of a unified front among business sectors.

Additionally, the right-of-center orientation of a government is understood as a catalyst for these hypothesized effects of elite cohesion. The first view would expect a right-of-center government to be better able to exchange information with business sectors and enjoy greater credibility among them than a left-of-center administration (Timmons 2010). This would result in right-of-center governments having an easier time extracting resources from economic elites than their left of center counterparts because "right governments can credibly commit to using tax revenue in ways that benefit those elites" (Fairfield 2011; p.13; Hart 2010).

In contrast, the second view would expect a right-of-center government to facilitate business' ability to prevent tax increases from taking place. This is because right-of-center governments may make it easier for economic elites to directly influence the decision making process, both through formal and informal consultation and even key positions in government (Gibson 1996). In short, the nature of business–government relations has been identified as an important factor of elite taxation. However, its effects are indeterminate: existing explanations based on empirical evidence from a variety of contexts point to opposite effects based on similar mechanisms.

Perceptions of Public Goods

A third potential explanation for elite taxation draws on research that associates willingness to pay taxes with the perceived quality of the public good. This view suggests that opposition to taxation is not uniform, but contingent on the perception of the benefit derived from the public good provided; taxpayers are more inclined to contribute funds toward government services the more they perceive a direct benefit from those services (Simonsen and Robbins 2003).

This connection has been found in a variety of goods, from relatively concrete to relatively intangible. For example, Hensher et al. (2005) find that perceptions of the quality of the tap water at home play an important role in determining how much to pay in taxes for this service. Similarly, Green et al. (1994) find that perceptions of the quality of public education are a determinant of willingness to pay school taxes. Furthermore, this relationship has been advanced for public goods and services provided by different levels of government—local, state, and national (Glaser and Hildreth 1999). Research in the former communist bloc (Hanousek and Palda 2004) and Africa (Prichard 2009; p. 36) suggests that the nexus between perceptions of the quality of the public good and willingness to pay taxes holds in developing countries.

Evidence supporting this explanation would point to improving perceptions of public safety. In particular, economic elites—the main target of the tax—would be expected to report better conditions to carry out their economic activities. Additionally, evidence would also point to an association between the role of the tax and those perceptions. Having discussed these theoretical considerations and their expectations, the following section assesses the extent to which these factors play out empirically.

Explaining Colombia's Security Taxes

As the following case study will show, these three perspectives play a differentiated role in explaining the adoption of the security taxes in Colombia. The advent of a crisis is helpful in explaining the adoption of the first security tax in 2002; elite cohesion played a key role in the renewal of the tax in 2003; and perceptions of improving security conditions among business elites did so in 2006 and 2009. Additionally, elite cohesion played a nuanced role, both in the government's ability to implement the tax and the protection of elites from less favorable types of taxes. The following case study is divided in three sections—each corresponding to the theoretical perspectives discussed earlier—and presents evidence for how each factor played out empirically.

Crisis as Impetus for Taxation

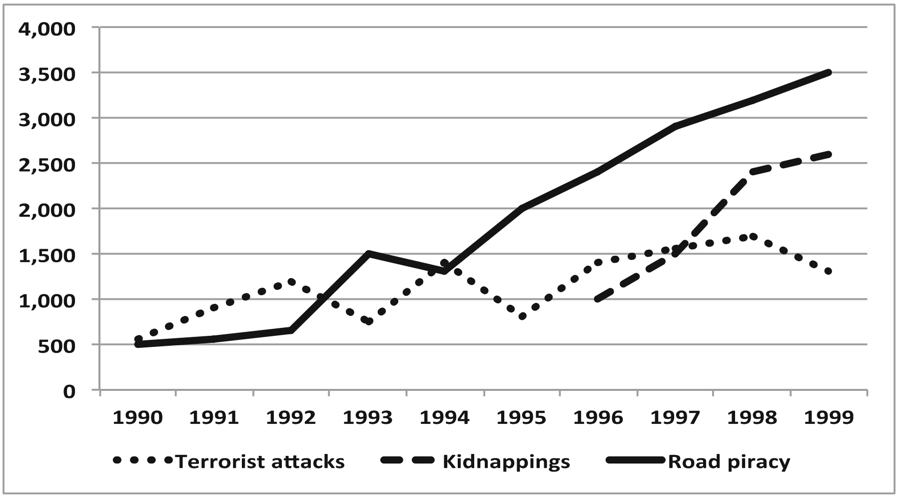
The 2002 Democratic Security Tax emerged as a result of a crisis perceived as pervasive and beyond the government's control. This crisis was both economic and security related. As this section notes, the crisis did not initially prompt elites to ameliorate their opposition to the adoption of the tax—as the theory might have suggested—but it did force the government to take extraordinary measures to secure resources, including declaring a state of emergency. These measures were effective in circumventing opposition and raising much-needed funds in a short period of time.

Uribe was inaugurated president of Colombia on August 7, 2002 amid a precarious security situation, dismal economic conditions, and discontent among the wealthiest taxpayers bearing the burden of mandatory security bonds. During the 1990s, an already bleak public safety environment had steadily worsened (Romero 2002). Armed groups constantly targeted the country's infrastructure, and traveling by road between cities became dangerous for the average Colombian (Restrepo 2006). Piracy and hijacking became common problems (Fig. 1).

Between 1998 and 2002, during Andrés Pastrana's presidency, this situation further deteriorated. The number of homicides increased by 18 % and the number of kidnappings by 15 % (DNP 2003). According to one estimate, about 15 % of the more than 2,500 kidnappings per year during this period involved the business community (Rettberg 2004; p. 5). Additionally, the line between drug traffickers, guerrillas, and paramilitaries became increasingly blurred as they cooperated to strengthen financially and operationally. Extortion and racketeering by these groups became pervasive. In large parts of the country, business and landowners were forced to pay to avoid attacks on their assets.[7]

In an attempt to respond to these challenges, Colombia more than doubled its security expenditures as a share of GDP between 1990 and 2002, from 1.5 to 3.3 % (Ministerio de Defensa Nacional 2008). In spite of this trend, “the government always seemed one step behind in its efforts to keep up with the equipment and weapons

[7] A famous example was the FARC's Law 002 (Rettberg 2002).



Source: Mindefensa 2009, 28. For kidnappings, no data are provided before 1996.

Fig. 1 Terrorist attacks, kidnappings, and road piracy in Colombia, 1990–1999

employed by guerrillas, paramilitaries, and drug traffickers because of lack of resources" (interview with Barco 2010).

In search of a solution to the armed conflict, the business sectors initially embraced and participated in *El Caguán* Peace Process (1999–2002)—the negotiations held in a demilitarized zone between Pastrana's administration and the Revolutionary Armed Forces of Colombia (FARC). However, Pastrana's attempts to negotiate with the guerilla groups were widely considered a failure (Rettberg 2007; p. 489). Broad sectors of society were disenchanted by the perception that the FARC had stood up the government at the negotiating table. By November 2000, a Gallup poll showed that only 11 % of respondents supported the continuation of the peace process, while 60 % supported stepping up the armed confrontation (*The Economist* 1999).

Upon the breakdown of the talks, business elites' disenchantment turned into vigorous support for Uribe's "strong hand" candidacy (interview with Llorente 2010). In a Gallup survey conducted among 498 private-sector executives from the largest 5,000 companies in the country, more than two-thirds of respondents supported a Fujimori-style, authoritarian government if the peace talks collapsed altogether (*El Tiempo* 1999). Thus, an overwhelming majority of respondents had reached a point in which they would willingly trade Colombia's long-standing democracy in exchange for public safety.

However, a fiscal crisis prevented Uribe from capitalizing on this support and delivering on one of his main campaign promises: increasing defense spending. During the 1990s, in an attempt to finance mounting security costs, governments mandated the purchase of bonds in exchange for modest returns (Ministerio de Defensa Nacional 2009; p. 25). In 1992, President César Gavíria (1990–1994) created the Bonds for Social Development and Internal Security.[8] Ernesto Samper (1994–1998) issued the Peace

[8] The Supreme Court ruled the bonds to be retroactive and therefore unconstitutional.

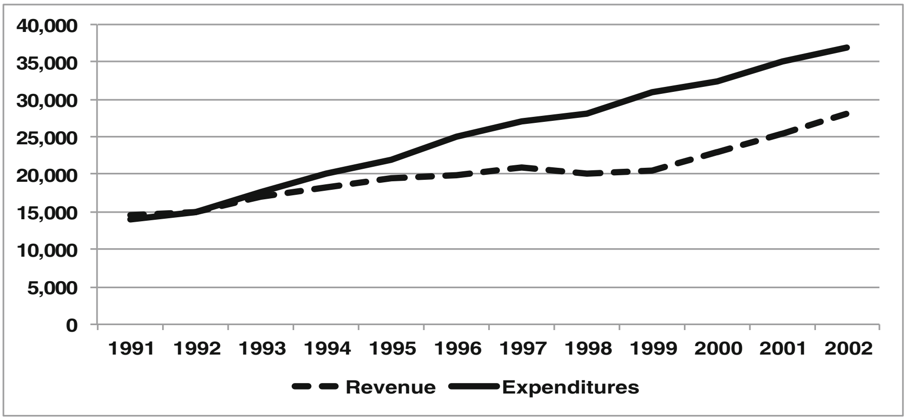
Bonds in 1996 and the Security Bonds in 1997. In a similar effort, Andrés Pastrana (1998–2002) created the Bonds in Solidarity for Peace.

Along with mounting security expenditures, the bonds contributed to the government's increasing gap between revenue and spending. Between 1995 and 2002, expenditures increased by 65 %, while revenue grew only by 46 % in real terms (Fig. 2). This discrepancy resulted in a ballooning public debt. In 1996, the net debt of the nonfinancial public sector represented 21.3 % of GDP (Fig. 3). By 2002, this debt had grown to 53 % of GDP. In a matter of 6 years, Colombia's public debt had more than doubled.

Moreover, the Asian crisis of 1997 and the Argentine crisis of 2001–2002 made it very difficult for Colombia to continue financing deficits through debt. As Uribe's finance minister put it, "we were desperate for resources and entirely shut out of the credit markets at the time" (interview with Junguito 2012). Reining in the drastic escalation of the debt became a priority for the government.

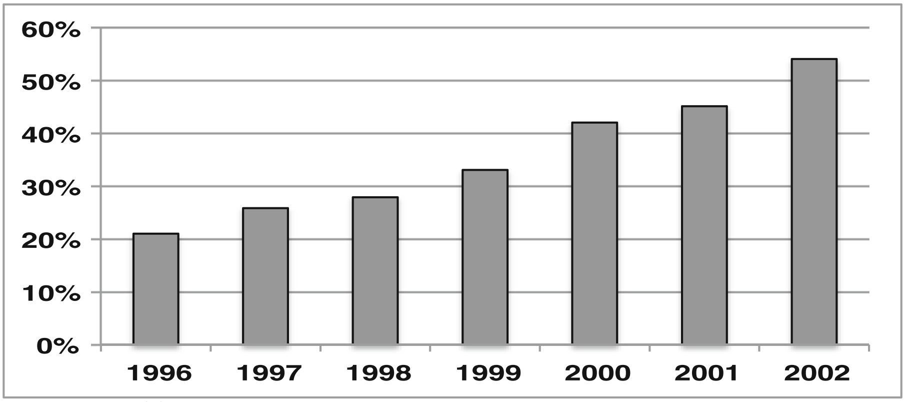
To make matters worse, the economy was facing strong headwinds, making the prospect of a revenue-increasing recovery very unlikely. Pastrana presided over one of the worst 4-year periods in decades: the economy contracted by 4.2 % in 1999 and averaged 0.6 % growth between 1998 and 2002. By the time Uribe took office in August of 2002, unemployment had reached 15 % and the Colombian peso had depreciated by almost 20 % in the previous 3 months. Without securing extraordinary resources, Uribe's administration would be unable to avoid bankruptcy, let alone follow through on his campaign promise to strengthen the government's security effort.

In this context, the new administration evaluated increases to the value added tax (VAT) and income tax rates. From the government's perspective, these taxes were more favorable than bonds, since the latter had to be paid back and contributed to expanding the government's fiscal burden (interview with Junguito 2012). This, in turn, affected the government's future ability to finance the security effort. In contrast, a tax did not mortgage the security effort since there was no obligation to pay interest on debt, and subsequent budgets would not be further constrained as a result.



Source: *Gaceta del Congreso* 2003, 11.

Fig. 2 Revenues and expenditures 1991–2002, National Central Government (Billions of 2002 COP$)



Source: *Gaceta del Congreso*2003, 11.

Fig. 3 Net public debt 1996–2002, non-financial public sector (% of GDP)

However, raising the VAT and income tax rates was also problematic. Additional revenue from these taxes would trickle into the government's coffers—because of how gradually they are collected—and the government could not afford to wait (interview with Ortega 2011). Moreover, these taxes would be paid by large sectors of the population and the political cost was deemed to be high (*El Tiempo* 2002a). In this context, maintaining—let alone expanding—current levels of security expenditures became unsustainable.

In spite of the crisis, business sectors' opposition to any extraction efforts remained vigorous, explicit, and public. The switch from bonds to taxes meant business elites would forego both the principal and interest returned to them previously. Additionally, they pointed to the lack of results of previous administrations, the need to broaden the tax base, and the economic downturn as reasons why they opposed any extractive measure (*El Tiempo* 2002b). For example, the Colombian Business Council (*Consejo Gremial*)—a semi-formal union of the country's most important business associations (Rettberg, Angelika 2005)—and the Association of micro-, small-, and medium enterprises (ACOPI) denounced that previous governments had lost credibility because taxpayers' money had been squandered. As the vice-president of the business council put it, "We had no idea whether the government used those funds as intended" (interview with Mejía 2011). Similarly, the Federation of Colombian Insurers (FASECOLDA) expressed concern that additional extraction would hinder economic growth even further, at a time "when the country could not afford to lose investment and stop generating much needed jobs" (*El Tiempo* 2002a). Additionally, the Automakers Association (ASOPARTES) and Confederation of Chambers of Commerce (CONFECAMARAS) demanded that the government broaden the tax base instead. Thus, between Uribe's election and his inauguration, business actively and publicly opposed any potential extraction efforts.

Even though the fiscal and security conditions did not prompt business elites to change views, they did prompt the government to take extraordinary measures. On August 11, 2002—4 days after taking office—Uribe assessed the security and fiscal situation to be so precarious that he resorted to extraordinary decree powers to achieve this goal. That day he decreed a State of Internal Commotion (*Estado de Conmoción Interior*) for 3 months, stating as the main reasons that "the entire Nation is submitted to a regime of terror in which democratic authority is capsizing and productive activities have become increasingly difficult to perform." (*Diario Oficial* 2002). "Moreover," the decree continued, "armed groups have successfully threatened the legitimate representatives of democracy, spreading anarchy and generating a sentiment of helplessness in wide sectors of the country."

In addition to referring to the country's precarious security situation, the decree also cited the government's fiscal troubles: "given the country's grave fiscal situation, the Nation does not have the necessary resources to finance the security forces and other state institutions in charge of addressing the issue; therefore, it is necessary to adopt new fiscal obligations." The same day, Uribe issued another decree mandating the creation of "a special tax toward financing the expenditures in the government's general budget necessary to preserve democratic security" (Diaro Oficial 2002a).

This course of action had two immediate consequences. First, in the fiscal realm, this measure addressed the problems of timing and collection. By mandating that the tax be collected in two installments, the government could extract extraordinary resources in a short period of time and make the tax relatively easy to pay. Additionally, a tax on liquid assets represented a relatively simple tax to collect because of the relatively small number of taxpayers.[9] Second, in the political realm, it circumvented the conventional policy making process typical of peacetime conditions. Rather than facing opposition from the business sectors and their potential allies in the legislature, the measure left dissatisfied actors the courts as the only recourse. Indeed, both the state of emergency and the tax were contested before the Constitutional Court. In the end, the government prevailed and began receiving the extemporaneous revenue shortly thereafter.

Business–Government Relations

Although the fiscal and security crises may explain the government's impetus to adopt a tax on the wealthy, they are less helpful in explaining subsequent adoptions of the tax.[10] Without the same sense of urgency generated by deteriorating fiscal and security conditions, other, less contingent factors are necessary to explain security taxes adopted in 2003, 2006, and 2009. One such factor is the nature of elite cohesion in business–government relations.

Elite cohesion was necessary for the adoption of the 2003 security tax, as well as the protection of business elites from more threatening tax arrangements in 2005. On the one hand, as one theoretical view on elite cohesion expected (Weyland 1997; Lieberman 2003), elites' cohesion and the right-of-center orientation of the president contributed to ameliorating opposition to Uribe's initiative. On the other hand, as the alternative view sustained (Fairfield 2010; Prichard and Hassan 2012), these factors also played an important role in deflecting other, more threatening measures that would have affected business elites' pockets more severely. In the end, elites saw in the security tax a compromise to avoid a more comprehensive tax reform.

[9] For a discussion of the prevalence of tax evasion in Latin America, see Bergman 2009.

[10] However, the memory of the crisis in subsequent years likely served as a benchmark for evaluations of public safety.

In the case of elite compliance, the main avenues for government–business collaboration discussed earlier—the establishment of linkages with key decision makers, consultation forums, and collaboration mechanisms—helped the government garner support for the adoption of subsequent security taxes in several ways. First, linkages between business elites and the executive branch prevailed throughout Uribe's administration. In line with his right-of-center orientation, Uribe appointed prominent members of the business community to key cabinet positions from the beginning of his presidency. This resulted in a cabinet formed by a majority of personalities with strong ties to the business community throughout his administration. In particular, the Ministry of Defense was led by Martha Lucía Ramírez, Jorge Alberto Uribe Echavarría, Juan Manuel Santos, and Gabriel Silva Luján; the Ministry of Finance was headed by Roberto Junguito Bonnet and Oscar Iván Zuluaga; the Ministry of Interior and Justice was led by Sabas Pretelt, the former head of the Colombian Business Council, to name a few examples. Naturally, not every minister was a member of the business community, but business leaders occupied numerous and prominent positions related to security and public finance.

Second, the affinity that resulted from the interweaving of business leaders and government contributed to meaningful consultation between the two. These linkages facilitated a series of meetings between the government and a handful of Colombia's most influential businesspeople at the presidential palace and Club El Nogal—an exclusive social club in Bogotá. At these meetings, Uribe himself laid out both the need to renew the tax and his plans to allocate the funds to the security effort (interviews with two anonymous cabinet members). This was one of business elites' main demands since the yearly economic costs of the conflict were deemed to be 2 % of GDP (Castro et al. 1999) in addition to another 2 % in private security expenditures (Álvarez and Rettberg 2008).

At the meetings, as a cabinet member put it, the government's linkages with business leaders allowed president Uribe to strike “a gentlemen's pact guaranteeing that, in exchange for the funds, the tax would be temporary and the extraordinary tax revenue would only be used towards security expenditures” (Anonymous member of Uribe’s cabinet 2011). As a result, these businesspeople first, and later the heads of Colombia's National Business Association (ANDI) and other business groups, gave their support to the president's initiative and committed to lobbying their affiliates on behalf of the proposal.[11] Business elites' cohesion allowed for a concerted effort among the business leadership that enabled the government to obtain business's support before presenting the initiative to Congress.[12]

Third, the nature of business–government relations also facilitated the establishment of ongoing cooperation mechanisms to address business' concerns. Although business acknowledged the need to provide additional resources to the state, they requested strict oversight of expenditures to ensure that resources be spent effectively (interview with Junguito 2012). Consequently, the government created a joint oversight committee—dubbed Ethics and Transparency Commission—to monitor security expenditures (interview with Pinzón 2011). Representatives of business, university presidents, the attorney general, and the comptroller general formed the commission, which held several meetings during the year and generated annual

[11] On business' influence in Congress see *Revista Dinero* 2011a.

[12] Two of Uribe's cabinet members, who asked not to be identified, provided this account separately in personal interviews.

reports of the government's procurement—a byproduct of the managerial background of the Defense Minister (interviews with Buendía 2010 and García 2010). Meetings were held in different locations to verify equipment acquisitions and monitor progress (interview with Giha 2011).

The ability to monitor the government's compliance with its own objectives addressed one of the business sectors' main concerns: that their contributions were reaching their intended purpose (interview with Vargas 2010). As a business leader who attended several of the Commission's meetings confided, "the meetings were important to us. We were able to visually corroborate the acquisition of equipment and to talk to defense personnel on the ground, sometimes the commander of a region, sometimes the officer in charge of an outpost, to evaluate progress" (interview with Mejía 2011).

However, these manifestations of elite cohesion—linkages, consultation forums, and cooperation mechanisms—also played a role in supporting the other theoretical expectation: protecting business elites from a more threatening tax reform than the temporary wealth tax and partially compensating them through deductions and exceptions. First, the business–government linkages and the right-of-center orientation of the president contributed to presenting a unified front against tax reforms that would target mainly the business sectors. On several occasions, the government publicly echoed business' opposition to add to the tax burden through more comprehensive tax reforms. Uribe argued that doing so would jeopardize economic growth and promised the business sectors—both in consultation meetings and publicly—not to follow that route (*El Tiempo* 2003a). Instead, the government pursued other less threatening ways to stretch the budget, including higher value added taxes, freezes for public sector wages and pensions, and exceptions for corporations (*El Tiempo* 2003b).

Second, consultation mechanisms between business and government contributed to the design of acceptable solutions. In June of 2003, the government convened 15 representatives of the main business sectors at the Presidential Palace to discuss the fiscal reform. At the meeting, the Minister of Finance and business leaders agreed to seek additional resources through changes to the value added tax instead of a security tax in order to distribute the burden more broadly among society. As a result, the government sent an initiative to Congress to increase the VAT. The legislature approved the adoption of a VAT of 2 % on basic consumption goods, such as milk, fruit, vegetables, and public transportation. In September of 2003, however, the Constitutional Court struck down the tax (*El Tiempo* 2003c). This left the government looking again for alternatives, particularly after its proposals to cut expenditures were defeated in a referendum in October of that year.

The government revised its initiative, again with the objective of making the additional tax burden much more diffuse. The new proposal included taxes aimed at different sectors of the population, such as a new wealth tax with a lower rate (0.4 %) and higher threshold (COP$3000 million or US$1 million), and an increase to the tax on financial transactions from COP$3 to COP$4 per COP$1,000. Significantly, the government pushed for an increase in the VAT rate from 16 to 17 % and a tax on pensions, which tends to affect the salaried sectors of society.

The government also sought to reduce the tax burden of business sectors, arguing that the reform should transcend the revenue generating impetus and stimulate economic activity (*El Tiempo* 2003d). Uribe proposed lowering the maximum marginal income tax rate from 35 to 15 % for corporations reinvesting their profits. In explaining the spirit of the reforms to the legislature, the government stated that it "asked *all sectors* of Colombian society to make comparable sacrifices and contributions" (*Gaceta del Congreso* 2003; p. 10).

On Dec. 29, 2003, Congress adopted a modified version of the government's proposal. The new measure included a new temporary security tax between 2004 and 2006 at a lower rate (0.3 %), a temporary increase in the income tax rate from 35 to 38.5 % for the same period, and an increase in the tax on financial transactions (*Diario Oficial* 2003). No consensus was formed among the main forces in Congress regarding other measures: the VAT increase and taxes on pensions were deemed to be too costly politically (interview with Castro 2010). Therefore, the government decided not to include them in the discussion of the joint chambers to avoid any potential delays in the approval of the reform, which was running out of time to come into effect in 2004 (*El Tiempo* 2003d).

In the end, the reform secured resources to maintain the government's security effort, but it also protected the interests of business. It expanded the tax base to lower income echelons, allowed companies to deduct up to 30 % of reinvested profits, and established sunset provisions for tax increases affecting business elites.[13] Immediately after the initiative was approved, Interior Minister and prominent business leader Sabas Pretelt took the tribune to thank legislators "for their courage and service to the nation" (*El Tiempo* 2003e).

In 2004, shortly after the 2003 tax was approved, the government promoted another concession to business elites: an exception for the wealthiest taxpayers in the form of Juridical Stability Contracts (*Contratos de Estabilidad Jurídica*). Approved by Congress as the Law of Confidence for Investors in July 2005, the contracts were an agreement between major investors and the Colombian government in which the government guaranteed the preservation of the legal framework ruling at the time a substantial investment was made. The spirit of the contracts was to attract investment by providing legal certainty. In exchange for stable rules of the game, the investor would pay the government 1 % of investments over 7,500 minimum wages or about COP$3,000 million (US$1.2 million) (*Diario Oficial* 2005).

The contracts provided tax relief to the some of the wealthiest taxpayers that the security tax had originally targeted. Liberal Party Representative Simón Gavíria (interview 2011) summarized the contracts' effect as, "making the security tax a discretionary tax, one that is not paid by everyone who is supposed to pay it." However, whenever this concern was raised by the opposition in Congress—mainly the few legislators from Polo Democrático Alternativo (interview with Borja 2011)—the pro-government majority (Conservative, Liberal, and Social National Unity parties) would close ranks to support the measure. They argued that much needed investment and jobs would be forgone and economic development would be compromised in the absence of the contracts. As Conservative Party Senator Óscar Darío Pérez noted, "if we have investors buy insurance, we have to make that commitment valid and insurance effective" (*Colprensa* 2009).

Toward the end of Uribe's presidency, 67 companies had signed such contracts with the Ministry of Trade, Industry, and Tourism. One estimate puts the amount foregone by the government since 2005 at about 10 % of the annual security tax revenue (*Revista Dinero* 2011b). However, Jorge Humberto Botero (2005), who

[13] The approval was controversial because the president convened an extraordinary session of Congress while many legislators were away for winter holiday recess.

played a key role in the initiative's approval as Minister of Commerce and has headed a number of prominent business associations, justified the contracts by stating that "the legal system is full of differentiated treatments whose validity is indisputable. Not all homicides receive the same sentence. There are laws that discriminate in favor of minorities. Likewise, it is indisputable that discriminating in favor of investment is praiseworthy." The ability to circumvent the security tax through these contracts remained in place until Uribe's successor eliminated it in December 2010.[14]

In short, the nature of business–government relations contributed, first, to garnering support behind the wealth tax among business elites, and, second, to protecting them from less palatable and more comprehensive fiscal reforms. In securing the approval of the tax, elite cohesion in the context of a right-of-center government served two main purposes. On the one hand, it provided confidence to the wealthy taxpayers that the government had their interests in mind. By incorporating prominent members of the business community into cabinet positions, it facilitated the interaction and communication between the key actors in government and business sectors to enhance transparency and improve accountability regarding how the money was spent (interview with Vélez 2011). Akin to a "Nixon goes to China effect," a president ideologically sympathetic to business interests had better chances of convincing business leaders that the wealth tax would be provisional, oversight over spending would be shared, and that their interests would be protected. These factors contributed to convincing the business sectors to accept paying the security tax.

On the other hand, these same factors also shielded elites from alternatives that were even less palatable to their interests. Members of the business community in Uribe's cabinet adopted pro-business positions and played a key role interacting with business leaders through consultation forums and cooperation mechanisms. Even though the government needed to generate additional revenue, it strived to make the burden more diffuse among broader sectors of society and to make the taxes temporary. Whenever unpalatable reforms were unavoidable, the government generated important exceptions favoring elites—including exceptions to corporate income tax rates and juridical stability contracts—partially offsetting the burden.

Thus, the 2003 security tax and the exceptions to elites that followed are an instance in which both hypothesized mechanisms of elite cohesion were at play. Linkages with business representatives in key positions, consultation forums, and cooperation mechanisms, allowed for a compromise solution. In exchange for the adoption of limited and temporary security taxes, business sectors avoided potentially more damaging reforms and were granted important exceptions, particularly among the wealthiest and most influential taxpayers.

Perceptions of Public Goods

A third factor responsible for the continuation of security taxes is perception of progress in the provision of public safety. This perception was important because the government explicitly linked the extraordinary wealth tax to security expenditures. Although the government could not formally earmark the funds for security expenditures because article 359 of the Constitution prohibits earmarks,[15] the government unambiguously linked the tax revenue de facto to the security effort in

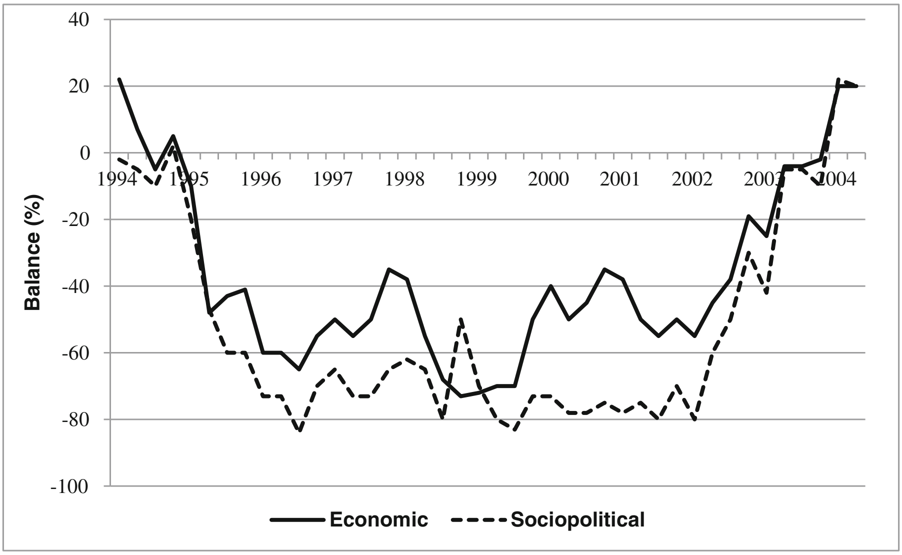
[14] Decree 4825 of Dec. 29, 2010. The Constitutional Court upheld the measure on April 4, 2011.

[15] The only exception is social programs.

practice in several ways. First, the name of the tax itself—Democratic Security Tax—alluded to the name of the government's security plan—Democratic Security Policy—and the tax became widely known as the “war tax.” Second, the government issued a series of reports outlining the security expenditures—wages, equipment, weaponry, and pensions—paid for by the tax. Third, as noted earlier, the president made a commitment to business leaders that the extraordinary tax revenue would only be used towards this purpose. Therefore, to the wealthy Colombians required to pay the tax, government performance on the security front “served as a barometer of whether the tax was worth paying” (interview with anonymous president of management consulting firm required to pay the tax 2011).

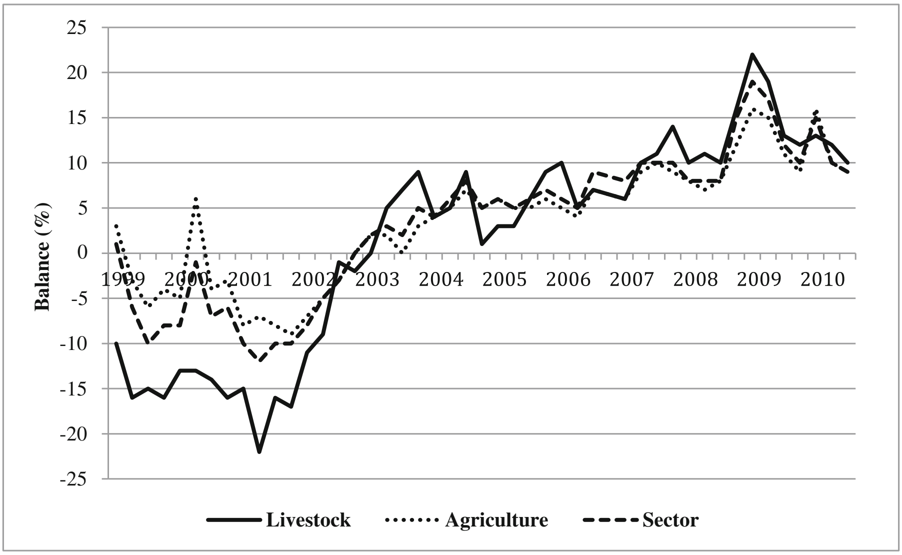
This “barometer” only trended upward following the state of emergency decreed on Uribe's first day in office. As public opinion surveys show, the business sectors noted an improvement of security conditions compared to Pastrana's presidency. For example, a Fedesarrollo survey conducted among business sectors showed that respondents believed sociopolitical conditions for investment improved steadily once Uribe took office (Rettberg 2004; p. 6). In particular, there was a sharp improvement in perceptions beginning in 2002 after a dip corresponding to the economic slump and the failure of Pastrana's peace negotiations (Fig. 4).

As Fig. 5 shows, the same trend is appreciated in a Colombian Agricultural Society survey among 1,872 of its affiliates in the agricultural sector (Sociedad de Agricultores Colombianos 2011; p. 17). The lines reflect a balance (in percentage terms) of the perceptions of safety. This balance is calculated by subtracting the share of respondents who identified public safety as unfavorable from the share identifying public safety as favorable. There is an inflection point in perceptions in early 2002,



Source: Fedesarrollo, *Encuesta de Opinión Empresarial*, May 2004, as shown in Rettberg, 2004, 6.

Fig. 4 Quarterly perceptions of economic and sociopolitical conditions for investment among business sectors, 1996–2004



Source: Sociedad de Agricultore Colombianos 2011.

Fig. 5 Quarterly balance of perceptions of public safety among affiliates of the Colombian Agricultural Society (*SAC*), 1999–2010

and by the end of 2003, favorable views surpassed negatives ones. These perceptions contributed to ameliorating opposition among business leaders to the renewal of the tax. Instead, many of them publicly endorsed it, arguing that "maintaining the security tax, now that the state's internal enemies have been decimated, is of utmost importance" (Lafaurie 2010).

As Figs. 4 and 5 show, there was a notable difference in perceptions of public safety between the adoption of the first security tax in 2002 and subsequent taxes, particularly in 2006 and 2009. Perceptions were around their lowest levels of the time series in late 2001/early 2002—right before Uribe became president. By December 2003, when the second wealth tax was adopted, a sharp, initial improvement in perceptions of safety conditions had already taken place among the business sectors.

The role of steadily improving perceptions is most noticeable in the approval of the 2006 and 2009 security taxes. In 2006, for example, perceptions hovered around highs not seen in over a decade. These perceptions allowed the government to push for the approval of the tax shortly after the beginning of Uribe's second term, arguing the need to consolidate the first term's security gains.

According to the Planning Department, the government faced a budget gap of COP$7.4 billion (US$3.2 billion) not accounted for in its projected defense and security expenditures between 2007 and 2010. This gap represented 13 % of the total defense and security budget (COP$57.9 billion or US$24.5 billion) for the period (DNP 2007; pp. 8–14). If the government wanted to increase, or at least maintain its security effort constant, it needed additional funds to sustain the human and material resources acquired in the previous 4-year period. Without these funds, the armed forces' investment in additional resources would also come to a halt. To make sure the connection was made between perceptions and the tax, the government dubbed it Democratic Security Consolidation Tax.

Perceptions of progress on security allowed members of the pro-government Conservative, Liberal, and Social National Unity parties to echo the government's claims. In particular, they appealed to the generalized “social impact” of the security measures that led to the improvement of conditions for an investment environment (interview with Posada 2010). They argued that improved security benefited all citizens alike, from the owner of the large business conglomerate to the small subsistence farmer, because “security generates trust, trust leads to private investment, private investment allows for social investment, which in turn justifies the further investment in security” (Gaceta del Congreso 2006; p. 4). On December 14, 2006, Congress renewed the security tax by more than two-thirds of the vote, granting the government extraordinary tax revenue for another 4-year period.

At the time the fourth tax was adopted in December 2009, perceptions were again at historical highs. Although still far from a generalized sentiment of mission accomplished, concerns about increasing the security apparatus to face the conflict began to give way to concerns about how to scale down the military apparatus (interview with Vargas 2010). Consensus around the improvements in security was such that most presidential candidates pledged to maintain Uribe's policies (Clavijo and Morera 2010). As leaders from several business organizations expressed in separate interviews,[16] these conditions made it difficult to oppose the government's request for the adoption of another security tax. This is not to say that support was unconditional, however. Business raised concerns about earmarked revenue funding current rather than capital expenditures (i.e., wages instead of equipment) and strongly opposed a government proposal to make the tax permanent.

It is worth noting that whether the security tax was mainly responsible for improving security conditions is much less relevant than whether it was associated with progress. Although the security tax compensated for shrinking foreign assistance (interview with Pinzón 2011), funds from Plan Colombia played an important role in stabilizing the security situation. Regardless of the actual role of the tax vis-à-vis other sources of revenue earmarked toward security, business elites' increasingly perceived that the government's strategy was improving the security situation.

Similarly, it is important to emphasize that this trend reflects perceptions among business elites—that is, many of those paying the taxes—and not necessarily actual improvement or society's agreement with the government's strategy. Indeed, there were several scandals related to the armed forces' poor handling of the security offensive. Among the most prominent are the “false positives,” in which economic incentives among the armed forces encouraged severe human rights violations, and the “parapolitics,” which involved the discovery of links between politicians and paramilitaries (interview with López 2010). Different sectors of society have denounced the government's actions and share discontent regarding its security policies.

[16] Federation of Cattle-Ranchers (FEDEGAN); Colombian Agricultural Association (SAC); Colombian Insurers Federation (FASECOLDA); and the Colombian Association of Electricity Generators (ACOLGEN).

Conclusion

This article documented the security taxes adopted during Uribe's presidency and identified the main factors that made them possible. As Colombia's historical difficulty in taxing elites suggests, the government's ability to extract extraordinary resources to finance the security effort was not guaranteed. Instead, the article showed that a combination of a crisis-based window of opportunity, elite cohesion, and improving perceptions of performance contributed to the adoption of taxes on the wealthy to fund the security effort.

Although the case study divided the adoption of elite taxation into three parts for analytical convenience, Colombia's security taxes should be understood as a process rather than discreet intervals independent of each other. The first event setting the process in motion was the combination of dire security conditions with a fiscal crisis that prompted the government to declare a state of internal commotion. Although the crisis did not end business elites' opposition to the government's extractive efforts, it did compel the government to adopt drastic measures leaving elites little choice but to comply. This allowed the government to circumvent potential opposition to the tax in the legislature and overcome the slow pace of alternative revenue-generating measures.

However, the crisis appears as a necessary but not sufficient condition for elite taxation. Without the close ties between business elites and the Uribe administration, the taxation effort was likely to fail beyond the initial one-time emergency measure. Subsequent taxes required congressional approval, and opposition among the business groups could have presented a serious obstacle for the government's plan. Indeed, business elites have presented governability problems in the past, as was the case with the acrimonious relationship between Ernesto Samper (1994–1998) and the business community (Schneider 2004).[17] Thus, the nature of business–government relations proved instrumental in extending the measure beyond an emergency palliative, allowing the government to help finance multiyear increases in security spending and the business community to preempt less favorable tax arrangements. This outcome suggests that the two views that scholars have advanced regarding the effects of elite cohesion are not necessarily competing, but complementary.

However, a key feature of the compromise appears to hinge on elites' ability to steer funds toward their spending priorities. Investing in security is a priority for elites over other government services (Fairfield 2013). This is because they may rely on private education or healthcare, but they cannot entirely rely on private security since high levels of violence in society directly affect their businesses. Thus, the tax arrangement results in a “substitution effect”: elites agree to pay a tax earmarked for security, but receive partial concessions on taxes for the general fund.

The third factor in the process, perceptions of the public good, played a supportive role by increasing the longevity of the security taxes. Naturally, without the initial stages made possible by crisis and elite cohesion, performance becomes moot because there would be no window for the government to show results with the new tax revenue. However, the findings underscore the importance of perceptions for the sustainability of taxation

[17] This contrast is also appreciated in El Salvador where business was unwilling to cooperate with President José Napoleon Duarte's peace efforts (1984–1989) but threw its support behind President Alfredo Cristiani (1989–1994) (Rettberg 2007).

(Simonsen and Robbins 2003). In spite of its many flaws, the government's security strategy managed to generate perceptions of progress among business elites. Otherwise, room for defeating the taxes in Congress would have increased.

These findings speak to a key question of the political economy of taxation, namely which factors enable developing countries to tax elites more effectively (Brautigam 2008). The combination of low levels of fiscal extraction, deteriorating security conditions, and mounting public safety expenditures is not uncommon in the developing world. Therefore, the insights derived from the Colombian experience may serve as lessons for other countries where protracted internal violence affects large sectors of society. El Salvador, Guatemala, Honduras, Mexico, Pakistan, the Philippines, and South Africa are cases in point. For example, there have been important efforts in the three Central American countries to adopt similar security taxes among elites. Although not all the factors that played out in Colombia will hold elsewhere, such as the tight business–government relations (Schneider 2004), these findings can help to provide a blueprint for places where addressing violence related to drugs, gangs, guerrillas, or paramilitary groups has become a serious challenge.

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