Fiscal panorama of Latin America and the Caribbean

Tax reform and renewal of the fiscal covenant

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Executive summary

Over the past decade (in particular since 2002), most countries in the region witnessed a substantial increase in their tax burden as a percentage of GDP, together with far-reaching structural changes, including consolidation of the value added tax (VAT), a significant improvement in the share of direct taxes in total tax receipts and a decline in tariffs on international trade. A number of factors contributed to this increase in the tax burden (albeit conditions varied significantly from one country to the other): stronger world economic growth, a steady rise in commodity prices, a favourable macroeconomic context, new taxes such as the tax on financial transactions or minimum taxes, cuts in exemptions or deductions, advances in tax administration and a reduction in inequality accompanied by a rise in consumption. Thus, between 2000 and 2011, total fiscal revenues strengthened from 19.6% to 23.6% of GDP in Latin America and from 24.5% to 28.3% of GDP in the Caribbean; meanwhile the tax burden (excluding social security contributions) climbed from 12.7% to 15.7% in Latin America and from 19.3% to 23.0% in the Caribbean.

The size of the increase varied across countries. The greatest improvements in the tax burden (in the narrow sense of the term, that is, without including social security contributions) occurred in Argentina and Ecuador and were equivalent to 2 or more percentage points of GDP in most countries. Nevertheless, progress was less significant in the group of countries (with the exception of Haiti) where the tax burden is lowest, while Bolivarian Republic of Venezuela and Mexico actually saw their tax burden (narrow sense) decline.

In those countries that rely on the exploitation of non-renewable natural resources, the State's share of the economic revenues and relative fiscal contribution of the export sectors of these resources (minerals and hydrocarbons) expanded during the last boom period, between 2003 and 2010, in contrast with the performance of the preceding period between 1990 and 2003. Between 1999-2001 and 2009-2011, income from the exploitation of primary products rose by 7.2 percentage points of GDP in Ecuador, 7.0 in Trinidad and Tobago, 4.5 in the Plurinational State of Bolivia, 3.0 in Argentina, 2.9 in Chile, 2.2 in Colombia and 1.4 in Mexico and Peru. Only in the Bolivarian Republic of Venezuela did revenue decline (by 0.4 percentage points), although, along with the other hydrocarbon exporters (Ecuador, Mexico, Plurinational State of Bolivia, and Trinidad and Tobago), Venezuela continued to rely heavily on non-renewable natural resources. In all of these countries, levies on non-renewable natural resources accounted for over 30% of total fiscal revenue. Other Latin American countries, including Chile, Colombia and Peru as well as Argentina, also benefited from the increase in raw material prices and exported huge volumes of minerals but their fiscal dependency on the latter was lower (at around 10% and 20% of total revenue) as they also received revenues from taxes on agricultural exports.

In the countries of the region with a hydrocarbon industry, governments obtain income directly from this industry by running State-owned enterprises, participating in joint ventures or renegotiating contracts with the exporting companies, as occurred in Ecuador. On the other hand, in the mining sector, where the role of State ownership in obtaining revenue has been more limited, but not altogether absent, royalties or other taxes have been instrumental in earning a minimum payment, for both national and subnational governments, in exchange for the countries' resources. Moreover, in most cases, public or private companies that exploit these resources have been charged the traditional income tax at differential rates, together with special levies, often applied at progressive rates.

From 2000 to 2011, VAT has continued to increase as a percentage of GDP across the region. During this period, the rate moved up from 5.1% to 6.7% in Latin America and from 5.4% to 7.1% in the Caribbean. This trend had begun four decades ago and more recently was extended to intermediate and end services. Initially, VAT had been applied almost exclusively to physical goods and some end services; since the 1980s, the overall rate has increased in almost all the countries of the region. However, it varies significantly from one group of countries to another and indirect tax rates have trended upward more sharply (as a percentage of GDP) in those Latin American countries where tax revenues are highest. The highest rates are observed in Argentina (21%), Brazil (20.5%, on average), Chile (19%), Peru (18%) and Uruguay (22%) and are similar to those applied in most of the European member countries of the Organisation for Economic Co-operation and Development (OECD). The rest of the countries in the region lag far behind, however; in some Caribbean countries where VAT reforms have recently been implemented, the rates applied vary from 12% to 17%, while Paraguay and Panama are exceptional cases with rates as low as 10% and 7%, respectively.

In some cases, the difference in VAT proceeds (and productivity) is due to differential exemptions and treatments. The countries with the most VAT-exempt operations include Bolivarian Republic of Venezuela, Colombia, Costa Rica, Ecuador, Mexico and Nicaragua. In the last five-year period (2008-2012), some reforms (especially in the Central American countries of El Salvador, Guatemala, Honduras and Nicaragua) sought to expand the VAT base by reducing the number of goods and services to which exemptions applied, or by laying down specific conditions under which certain exemptions could be given. In other countries (Bolivarian Republic of Venezuela, Mexico and Peru) the rates were increased without any alteration in the tax base, while, in most countries where the rates rose, the tax base tended to decline selectively with zero rates or exemptions applied to certain categories (Barbados, Colombia, Jamaica, Panama, Saint Kitts and Nevis, Saint Lucia and Turks and Caicos Islands). Dominican Republic was the exception: rate increases were matched by reductions in exemptions or categories to which the zero rate applied, which suggests that this reform will be more successful in increasing revenue collection here than in other countries.

Two significant innovations in indirect taxation occurred in the last five-year period. On the one hand, in Uruguay, low-income households making credit-card payments were exempted from VAT. This helped to make the system more equitable, since it ceased to exempt all income levels from the tax on staple goods and focused on exempting low-income persons directly

through an electronic transfer of funds. On the other, as part of a relative increase in excise duties, environmental considerations are increasingly being used as a criterion in taxation, the most obvious example being the motor vehicle tax (Ecuador and Panama), but another case being the tax on plastics and fuels (Ecuador and Peru).

Income tax in Latin America (simple average) as a percentage of GDP is estimated to have increased from approximately 3.2% of GDP in 2000 to 4.9% in 2011, while in the Caribbean, it is reported to have gone up from 6.3% to 7.7%. The proceeds of this tax as well as its equity have declined owing to a bias that favours companies over natural persons, the significant number of exemptions and deductions, a high personal tax allowance and the fact that it is a schedular tax.

However, in the last five-year period, various income-tax reforms were introduced in Latin America and the Caribbean, with rate hikes in several cases (Chile, Ecuador, El Salvador, Honduras, Mexico, Peru, Plurinational State of Bolivia and Uruguay) and expansions in the tax base of the income tax. In some cases, certain rates were lowered (Dominican Republic, Guatemala, Guyana, Jamaica, Nicaragua and Panama) or the tax base was reduced either as a result of new exemptions or deductions (Chile and Panama) or because the personal tax allowance had been raised in some countries (Guatemala, Nicaragua and Panama). Nevertheless, the dominant trend in the region is the expansion in the tax bases and the positive impact this has had thanks to the extension of taxation to all labour income and capital income, including dividends (Colombia, Dominican Republic, Guatemala, El Salvador, Jamaica, Nicaragua, Panama and Peru), as well as other measures including the establishment of minimum taxes, a cut-back on exemptions, the decision to limit deductions to certain specific expenses, a gradual reduction in the level of real income to which the marginal maximum tax rate applies and some control of transfer pricing.

Some of the more recent reforms are characterized by two relatively new features. Several reforms were inspired by the dual tax applied in the Scandinavian countries and Uruguay (2007). The Dominican Republic, Peru and several Central American countries (El Salvador, Guatemala, Honduras, Nicaragua and Panama) adopted tax reforms establishing standard rates for taxing capital income, together with higher corporate tax rates and progressive taxes on labour income, a situation consistent with the Uruguayan version of the dual income tax.

The other innovative feature of the income tax system, evident in particular in the case of income tax reform in Colombia (2012) is a still incipient practice consisting in the use of this tax as an instrument for boosting formal employment, eliminating the surcharge on the payroll amount and obtaining funds which, as a result of this measure, were no longer being collected under the fixed assets tax. This has helped to shift the tax burden from companies in sectors that employ more formal workers towards those, such as the mining sector, that are more capital-intensive.

In the past, revenue from wealth taxes has been very low in Latin American countries, although the tax on financial transactions has proven to be an appropriate instrument for bringing in significant revenues in the short term, albeit with variations from one country to the next. At different times, Argentina, Brazil and Colombia have succeeded in raising

between 0.6% and 1.9% of GDP but the yields have not been constant. The Dominican Republic, Peru and the Plurinational State of Bolivia have applied this type of tax but in 2010, the yield was barely over 0.2% of GDP.

The total fiscal revenue of the subnational governments increased considerably in the past few years, owing mainly to transfers from the central governments and not to any increase in tax funds collected at the intermediate and local levels. Brazil is an exception as the subnational governments (of the states and municipalities) contribute close to 28% of the total tax revenue (some 9.1% of GDP). The second category of countries includes Argentina and Colombia, where approximately 15% of total revenue is collected at the subnational level. The governments of the remaining countries have not made significant progress in this regard and subnational tax revenue accounts for between 1.5% and 6.2% of total tax revenues in each case.

The taxes that most frequently are attributed to subnational entities are property tax, motor vehicle licences, rates for specific services, and certain municipal rates, all of which have only a limited revenue-generating potential compared with the tax bases attributed to the central government, which include VAT and income taxes. In the countries of the region with the highest tax burden at the subnational level, certain excise taxes play a significant role and have become the main source of tax revenue at their respective level of government.

Various types of empirical evidence suggest that there is reciprocal relationship between taxpayers and the State, reflected concretely in the fact that most households declare that they are willing to pay higher taxes providing that there is an improvement in the quality of public services in the areas of health, education and public security, that corruption is eradicated and tax evasion brought under control. In this regard, proposals for enhancing this reciprocity by improving the quality of public management suggest that this can help to promote fiscal policy strategies (implicit or explicit fiscal covenants).

However, some elements weaken this reciprocal relationship between citizens and the State; in fact, three types of incomplete or perverse reciprocity exist which erode the chances of reaching comprehensive or sustainable social contracts or fiscal covenants. In practice, reciprocity can become exclusionary, unnecessary or asymmetrical. It is exclusionary when there are large swathes of the population that have a tenuous or non-existent relationship with the State and who feel that they derive no benefits from State services. This is the case of the sectors that are deprived of social protection, marginalized and, in many cases, the main victims of the lack of public security; the informal sector is one example of this form of exclusion. Reciprocity between the State and taxpayers may be unnecessary when institutions are weak and public revenue comes mainly from natural resources or certain strategic assets. In this case, the State does not need to establish reciprocal relationships or to negotiate with its citizens. Lastly, reciprocity may be asymmetrical insofar as there is evidence of inequality in the economic and political power, when there are de facto power groups with the right of veto.

In the face of these situations of flawed reciprocity, the renewal of the fiscal covenant could be promoted by strengthening reciprocity in a generally inclusive and egalitarian sense. Moreover, an inclusive reciprocity would be promoted through policies that tend to formalize

employment, bearing in mind that the existence of informal employment is one of the most important manifestations of exclusionary reciprocity between citizens and the State. Based on proposals or reforms already implemented in the region, in particular in the case of Colombia, the first course would be to advocate tax reforms (especially with respect to direct taxation) that do not jeopardize formal employment. The second strategic direction would be to use a rights approach to strengthen the universal coverage of public expenditure. For example, a universal social security system that would favour and not detract from formal employment, in addition to universal health services, would assuredly contribute to a closer relationship between most citizens and the State.

In terms of the unnecessary reciprocity that may arise from the receipt of a high proportion of non-tax funds by the central or subnational governments, two additional strategic directions would be justifiable. The first would be to establish sound, transparent and sustainable fiscal institutions. This could be reflected in structural rules for fiscal balance, medium-term fiscal frameworks, sovereign wealth funds, externalization of fiscal revenue projections and the creation of independent councils for fiscal policy appraisal. The second strategic direction would consist in consolidating further the institutional framework responsible for taxation. In a number of countries, this has already given rise to significant advances in tax administration.

Lastly, as regards asymmetrical reciprocity, which includes the effect of stakeholders that hold veto powers, equality before the law must be enforced; the challenge in this regard will be to apply the rule of law in the fiscal sphere, and, in particular, to strengthen the judicial bodies responsible for imposing sanctions for tax infringements; furthermore, special attention must be paid to corruption linked to public expenditure. Advances must also be made in the sphere of horizontal equity (eliminating fiscal privileges and special exemptions) as well as in vertical equity, bearing in mind that taxation does little to correct the gaping inequalities that exist in the region. In countries like those of Latin America and the Caribbean where inequality is rife, public spending alone cannot be relied on to reduce inequality but taxation must also play its part. Given that efforts to move forward in the sphere of taxation and fiscal policy in general inevitably generate disputes or differences, agreement on a social contract on fiscal policy calls for a long-term political vision, to which the majority can subscribe and that can be gradually implemented and constructed, subject to negotiations along the way, but without losing sight of the strategic and inclusive objective and ensuring a broad-based and constant reciprocity, based on equality, between citizens and the State.

I. Main features of taxation in Latin America and the Caribbean

Introduction

This study provides an up-to-date overview of taxation in Latin America and the Caribbean —analysing the share of tax revenue in the total income of public sectors across the region, and the importance of levies charged on the exploitation of natural resources, value added tax (VAT), income tax, taxes on capital, and revenues raised by subnational governments. The analysis also describes the key tax reforms introduced in the region over the last five years.

A second part of this document sets out a reciprocity-based policy framework through which to investigate tax-policy issues. It identifies some of the determinants of taxation in individual countries and explains how inclusive and egalitarian reciprocity between citizens and the State can be eroded in practice in the region. Based on this overview, the recommendation is to strengthen reciprocity through policies that encourage the formalization of employment, institutional strengthening and equality, as foundations for a renewed fiscal covenant in the region.

A. Increased tax burden in Latin America and the Caribbean over the last decade

Over the last decade (and particularly since 2002), most of the region's countries experienced a sharp increase in their tax burden in relation to gross domestic product (GDP), together with major structural changes such as the consolidation of VAT, a significant increase in the share of direct taxes, and a reduction in duties on international trade. Despite the critical opinion that many analysts hold of the Washington Consensus and its consequences for the Latin American economies, its influence on some of the "strengths" of current tax system cannot be denied; nonetheless, it is also associated with many of the weaknesses in those systems today. The emphasis on improving the tax administration, strengthening VAT, and simplifying tax structures is rooted in that context and usually hailed as one of the achievements of the Consensus; whereas the poor distributive effects of individual taxes, lack of horizontal equity and weak income taxation that persist in countries across the region are generally counted among its main faults.

A new phase in Latin American taxation has been unfolding since the mid-1990s, and especially over the last decade. The level of tax revenue as a percentage of GDP has trended upwards not only as a regional average but also in most Latin American and Caribbean countries individually. Between 2000 and 2011, the average tax burden in Latin American countries, including contributions to state-run social security systems, rose from 15.4% to 19.1% of GDP

(see table I.1).[1] If social security contributions are excluded, however, the tax burden rose from 12.7% to 15.7% of GDP during the same period in Latin America, and from 19.3% to 23% of GDP in Caribbean countries.[2]

Table I.1

LATIN AMERICA AND THE CARIBBEAN: TAX REVENUES, 2000 and 2011

(Percentages of GDP)

Country	Tax revenues, excluding social security		Tax revenues, including social security		Total income	
	2000	2011	2000	2011	2000	2011
Group 1						
Argentina	18.1	27.4	21.5	34.9	25.0	38.0 [a]
Brazil	23.0	26.0	30.1	34.8	32.5	38.3 [a]
Uruguay	14.6	18.6	22.5	26.5	27.4	29.0
Group 2						
Bolivia (Plurinational State of)	16.3	20.4	17.9	22.1	26.7	34.5
Costa Rica	12.6	14.4	18.9	22.0	21.3	24.1
Chile	16.9	18.9	18.2	20.2	21.9	24.6
Ecuador	8.9	14.4	10.1	20.1	19.0	31.2
Nicaragua	11.2	15.2	13.5	19.0	16.8	21.8
Colombia	11.6	16.2	14.0	18.1	17.7 [a]	22.4 [a]
Panama	9.6	11.3	16.0	17.8	24.6	24.3
Peru	12.4	15.3	14.1	17.0	17.0	19.4
Paraguay	9.3	12.1	12.5	16.1	18.1	21.7
Honduras	13.8	15.0	14.3	15.8	16.2	18.3
El Salvador	10.2	13.9	12.4	15.5	14.2	17.1
Group 3						
Haiti	7.9	13.1	7.9	13.1	8.2	14.3
Guatemala	10.5	10.9	12.4	12.8	14.1	13.6
Dominican Republic	11.2	12.7	11.3	12.8	13.3	13.5
Venezuela (Bolivarian Republic of)	12.9	11.9	13.6	12.5	20.9	23.0
Mexico	10.1	9.7	11.9	11.4	17.4 [a]	19.5 [a]
Caribbean						
Suriname	22.2	32.4	...	...	29.8	43.0
Trinidad and Tobago	21.4	29.2	...	...	25.4	33.0
Barbados	25.6	27.4	...	...	27.5	29.1
Dominica	20.8	23.9	...	...	27.6	29.9
Jamaica	22.5	23.4	...	...	26.1	26.1
Belize	17.2	23.4	...	...	26.1	28.0
Saint Vincent and the Grenadines	20.2	22.2	...	...	25.3	26.5

[1] Table 1 classifies Latin American countries according to their average tax burdens in the period 2005-2011 (18.1% of GDP). The countries are divided into three groups: (i) those with tax burdens that are more than 20% above the regional average (group 1); (ii) those that are within +/-20% of that average (group 2); and (iii) countries that have tax burdens of at least 20% below the regional average (group 3). The Caribbean countries (both English- and Dutch-speaking) are in a separate group.

[2] Excluded because social security provision in the region is organized in a variety of ways (both public and private).

Table I.1 (concluded)

Country	Tax revenues, excluding social security		Tax revenues, including social security		Total income	
	2000	2011	2000	2011	2000	2011
Saint Kitts and Nevis	16.7	21.7	...	...	25.0	39.3
Saint Lucia	20.9	21.4	...	...	24.5	23.9
Guyana	18.3	21.2	...	...	23.2	25.6
Grenada	18.6	18.3	...	...	23.6	22.1
Antigua and Barbuda	13.3	18.3	...	...	19.0	20.6
Bahamas	13.5	16.4	...	...	15.1	20.2
Group 1	18.6	24.0	24.7	32.0	28.3	35.1
Group 2	12.1	15.2	14.7	18.5	19.4	23.6
Group 3	10.5	11.7	11.4	12.5	14.8	16.8
Latin America (19 countries)	12.7	15.7	15.4	19.1	19.6	23.6
Caribbean (13 countries)	19.3	23.0	...	...	24.5	28.3
Cuba	33.3	34.5	37.2	38.8	48.8	65.7
OECD (34 countries)	26.3	24.7	35.2	33.8	41.4 [a]	40.5 [a]

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures and Organization for Economic Cooperation and Development (OECD), OECD Tax Statistics Database.

Note: The figures refer to central government, except in the cases of Argentina, Brazil, Chile, Colombia, Costa Rica, Cuba, Mexico and the Plurinational State of Bolivia, where they correspond to general government. In the case of Guatemala, in addition to central government incomes, the figures include the Single Property Tax (IUSI) levied by the municipalities, together with revenues obtained from the accommodation tax and tourism card by the Guatemalan Tourism Institute (INGUATE), and contributions to the Guatemalan Social Security Institute. The figures for Paraguay include contributions made to decentralized social security institutions. The most recent data available for Cuba and the OECD (34) average refer to 2010.

[a] Estimates.

This increase in the tax burden was driven by various factors, some of which extend beyond the realm of taxation domain, strictly defined, including the following:

(a) an international backdrop of faster global economic growth;

(b) the sustained rise in international commodity and mineral prices that occurred between 2002 and 2009, which boosted fiscal incomes in the region's countries that specialize in the exploitation and commercialization of their natural resources (these fiscal incomes are partly taxation);

(c) a favourable macroeconomic context, with substantial reductions in individual countries' public accounts deficits and debt levels;

(d) social policies which, in addition to encouraging formal-employment growth in several countries, also succeeded in reducing levels of inequality and fuelled an expansion in private consumption and taxes on goods and services;

(e) the introduction of new taxes on financial transactions, which broadened the range of tax policy instruments;

(f) the reduction and abolition of numerous tax exemptions, deductions and benefits granted in past decades with a view to attracting foreign investments, but which did not always produce the expected results; plus the introduction of minimum taxes which raised income-tax compliance rates;

(g) improvements in the administration of VAT and income tax, leading to rapid growth in the corresponding revenues; and, as a consequence of this and the other factors mentioned above, an increase in the (ex post) tax elasticity of Latin American countries (Cornia, Gómez Sabaíni and Martorano, 2011).

Tax burdens have grown unevenly across the region, mainly reflecting the different tax policies implemented in each country. Argentina and Ecuador are those in which the burden has increased most since 2000 (by about 10 percentage points of GDP, when social-security contributions are included). In Argentina, this reflected the introduction of export duties as from 2002 and larger social security contributions after the system was nationalized in 2008. In Ecuador, the increased tax burden reflects the cumulative effects of successive tax reforms, particularly in relation to income-tax revenue and the negotiation of new contracts with oil-exporting firms.

In other countries, such as Brazil, Colombia, Haiti, Nicaragua, the Plurinational State of Bolivia and Uruguay, this indicator rose by between 4 and 5.5 percentage points of GDP between 2000 and 2011; and it also increased in Cuba, which already had the region's heaviest tax burden. Countries with the lowest burden include the Bolivarian Republic of Venezuela and Mexico, which were the only ones to report a reduction in tax revenue in relation to GDP and also have highly volatile oil revenues. The disparity across the region stems from the fact that, while tax burdens in countries such as Argentina and Brazil are even above the OECD average, other countries in the region raise barely one third of those revenue levels. Nonetheless, the gap between the two averages has been narrowing during the present century, as a result of the significant increase in tax pressure in Latin America and a reduction in the OECD.

Nonetheless, the picture changes when the total fiscal income of the region's countries is considered, since several of them supplement their tax revenues with large amounts of non-tax income obtained from other sources, or from the exploitation of natural resources, as will be analysed in greater detail in section B. In the group of countries with the lowest tax burden (group 3 in table 1), the Bolivarian Republic of Venezuela and Mexico had the region's lowest tax revenues, but they also boost their fiscal incomes with substantial oil revenues. That group also includes the Dominican Republic, Haiti and Guatemala, which generate very small amounts of non-tax income to make up for low tax pressure. Other countries, such as Chile, Ecuador and the Plurinational State of Bolivia, with tax burdens above the regional average (group 2 of table 1), supplement their tax revenues with non-tax fiscal incomes obtained from the exploitation of hydrocarbons or minerals. Lastly, there are countries that complement their tax revenue with funds raised from other sources, such as the Inter-Oceanic Canal in the case of Panama, the hydroelectric plants in Paraguay, or foreign grants in several Caribbean countries and in Haiti, Honduras and Nicaragua.

B. Increase in rents obtained from the exploitation of natural resources

The period of burgeoning global economic growth between 2003 and 2008, supported by a boom in the international demand for commodities exported by the region, largely explains the stronger macroeconomic performance and fiscal position of the region's exporting countries from 2003 onwards. In those specializing in the exploitation of natural resources, the State took a larger share of the economic rents and relative fiscal contribution of sectors exporting non-renewable resources (minerals and hydrocarbons) during the latest boom period 2003-2008, in contrast to the performance in the preceding period 1990-2003. This can also be viewed in terms of current institutional frameworks becoming more effective in publicly appropriating wealth obtained from extractive activities (Aquatella, 2012).

The exception has been the Bolivarian Republic of Venezuela, where income from these sources dropped sharply in the 1990s. Nonetheless in recent years (2009-2011) the fiscal income it obtained from natural resources was still one of the region's largest, along with Ecuador, Mexico, the Plurinational State of Bolivia, and Trinidad and Tobago (see table I.2). Moreover, Venezuela is the country in the region that depends most on such resources, which accounted for around 40% of total income during the three-year period 2009-2011, although the trend has been clearly declining. Other countries in the region have also relied heavily on income from the exploitation of natural resources in recent years —Ecuador (34.5%), Mexico (32.5%), the Plurinational State of Bolivia (29.9%) and Trinidad and Tobago (45.8%)— and to a lesser extent Chile (17.3%), Colombia (16.2%), Argentina (13.6%) and Peru (9,3%).[3]

Table I.2

LATIN AMERICA AND THE CARIBBEAN (9 COUNTRIES): FISCAL INCOME OBTAINED FROM THE EXPLOITATION OF COMMODITIES, 1999-2011AND 2009-2011

	1999-2001	2009-2011	1999-2001	2009-2011
	(percentages of GDP)		*(percentages of total income)*	
Argentina	0.0	3.0	0.1	13.6
Bolivia (Plurinational State of)	5.1	9.6	20.5	29.9
Chile	0.8	3.7	3.8	17.3
Colombia	1.2	2.4	10.2	16.2
Ecuador	6.3	13.5	30.8	34.5
Mexico	6.1	7.5	31.2	32.5
Peru	0.2	1.6	1.2	9.3
Trinidad and Tobago	6.7	14.7	27.5	45.8
Venezuela (Bolivarian Republic of)	8.7	8.3	44.0	39.2

Source: Economic Commission for Latin America and the Caribbean (ECLAC) on the basis of official figures.
Note: The figures refer to central government in the cases of Argentina, the Bolivarian Republic of Venezuela, Chile, Colombia, Peru, and Trinidad and Tobago; general government in the case of the Plurinational State of Bolivia; the non-financial public sector in the case of Ecuador; and the public sector in Mexico.

[3] Although most studies for Latin America tend to focus on countries whose exports and fiscal income rely heavily (generally above 30%) on non-renewable natural resources, other countries, such as Brazil, Guatemala and Honduras, also obtain fiscal income from the exploitation of these resources, albeit in much smaller amounts.

In countries of the region that have large endowments of non-renewable natural resources, particularly hydrocarbons, the most direct way in which governments have appropriated commodity-export earnings and turned them into fiscal resources has been by taking a share of operating earnings, either through public enterprises or through equity holdings (CAF, 2012).[4] The firms in question are usually subject to a special tax regime, which may involve payments of rents or royalties, additional taxes on public enterprises, or special taxes levied on the production of a given resource.

Between 2005 and 2012, the most important legal reforms aimed at ensuring public control of non-renewable natural resources targeted the hydrocarbons sector. Measures included sector nationalization through firms of mixed ownership in the Bolivarian Republic of Venezuela (2005 and 2007); nationalization of hydrocarbons and re-nationalization of the Huanani tin mine in the Plurinational State of Bolivia (2006); renegotiation of oil contracts in Ecuador, under which the government receives 100% of any increases in oil prices (2010); expropriation of 51% of YPF shares in Argentina (2012); and nationalization of the Colquirí mine in Oruro, Plurinational State of Bolivia (2012).

Governments have also used other state appropriation mechanisms, such as royalties, usually production-based, and specific taxes (see table I.3). This has been particularly important in the mining sector, where relatively smaller amounts of resources have been obtained through state participation in the respective enterprises. Royalties and specific taxes have made it possible to ensure a minimum payment is made for the resources both to national and subnational governments; and a growing number of countries have reformed their royalty systems for this purpose, including the Plurinational State of Bolivia (2005), Ecuador (2010), Colombia (2011) and Peru (2011). Moreover, most countries have also applied the traditional income tax with differential rates, in conjunction with other special taxes,[5] often at progressive rates, levied on public or private enterprises engaged in the exploitation of non-renewable resources. This been strengthened through reforms undertaken in Chile (2005), the Bolivarian Republic of Venezuela (2006, 2008 and 2011) and Peru (2011).[6]

As noted in ECLAC (2012), the region's countries have historically found it difficult to harness commodity-export boom periods to long-term economic development processes. Nonetheless, in

[4] These include YPF (Argentina), YPFB (Plurinational State of Bolivia), Petrobras (Brazil), Ecopetrol (Colombia), Petroecuador (Ecuador), Pemex (Mexico) and PDVSA (Bolivarian Republic of Venezuela). In Ecuador, changes to service contracts also provided a fundamental source of additional fiscal income.

[5] As noted in OECD/ECLAC/CIAT (2011), this diversity of instruments used in the region poses measurement challenges when identifying the share of total tax revenue attributable to natural resources, renewable or otherwise. Some revenue measurements explicitly include the exploitation of non-renewable resources as the basis of taxation, which makes it easy to assign them to the resources sector, although not all are classified as taxes. In fact, in some cases, it can be very difficult to apply criteria to distinguish a tax. The best example of this involves the duties on hydrocarbons production in Mexico, where there is no general consensus that they should be classified as a tax. For a detailed analysis, see Gómez Sabaíni and Jiménez (2011b), CAF (2012).

[6] In Chile, in addition to first category income tax, there is an additional 35% tax on profit remittances, a special 40% tax on the profits generated (for public enterprises only), and a specific tax on mining activity charged at progressive rates. The Bolivarian Republic of Venezuela sought to raise rates of taxation on oil revenues in 2005, while creating three new taxes: (a) on crude oil extraction; (b) on the export register; and (c) on exceptional prices (created in 2008, and raised in 2011); while in Peru (2011) the Special Mining Tax (IEM)and Special Mining Duty (GEM) were created, both charged at progressive rates on operating profits.

recent years, Latin America has seen the benefits of having the capacity to deploy counter-cyclical policies to cushion the impact of the international crisis, through the management of fiscal savings made during the 2003-2008 commodity-price boom. The instruments used to achieve this include stabilization funds —financed with surplus income from copper exports (Chile), or based on oil income (the Bolivarian Republic of Venezuela, Colombia, Ecuador and Mexico).

Table I.3

LATIN AMERICA AND THE CARIBBEAN (10 COUNTRIES): CHARACTERISTICS OF FISCAL REGIMES APPLIED TO NON-RENEWABLE PRODUCTS

Country and product	Royalties (rates)	Income tax (general rate)	Other taxes on income (rates)	Other levies	Public participation
Argentina (oil and mining)	12%-15%; or 5% for marginal deposits (oil) 0%-3% (mining)	Profits tax: 35%		Export duties (25%-45%, 100% for hydrocarbons and 5%-10 for mining). Taxes on liquid fuels, natural gas, gas oil, liquefied gas, naphthas and compressed natural gas. Mining duty	YPF (hydrocarbons)
Bolivia (Plurinational State of) (hydrocarbons)	Departmental royalties: 11% Compensatory national royalties: 1% National royalties (National Treasury): 6%	Tax on the profits of state enterprises (IUE): 25%	Tax on profits-beneficiaries abroad: 12.5% [a]	Direct hydrocarbons tax (IDH): 32% Special tax on hydrocarbons and derivatives (IEHD)	YPFB (hydrocarbons)
Brazil (hydrocarbons)	10% of the value of production (can be reduced to 5%, depending on geological risk and other factors)	Income tax is 15%, plus a surcharge of 10% if profits are above R$ 240,000 per year	Special participations: 10%-40% Tax on profits -beneficiaries abroad: 15% (or 25% for payments to tax havens)	Social levy on net profit: 9% CIDE: 10%	Petrobras (hydrocarbons)
Chile (mining)		Tax on first-category income: 20%	Tax on profit remittances 35% and Tax on interest remittances 4%. Special 40% tax on profits (for public enterprises)	Specific tax on the operating income of mining activity: progressive rates between 0.5% and 14%. Tax with revenue earmarked for the Armed Forces (Reserved Law): 10% of foreign currency earnings from exports of CODELCO copper production.	CODELCO (copper)
Colombia (oil and mining)	8%-25% (oil) and 1%-12% (mining)	Company tax: 25% Income tax for equity (CREE): 9% for 2013-2015, 8% thereafter		Oil Pipeline Transport Tax. National Gasoline Tax and ACPM ANH duties	Ecopetrol (hydrocarbons)
Ecuador (oil)	12.5%-18.5% (of gross crude oil production)	Income tax: 23%	The State reserves for itself 25% of gross income from the contract area [b]	Labour share: the State receives 12% of profits (destined for decentralized autonomous governments)	Petroecuador (hydrocarbons)
Mexico (oil and mining)		Oil Revenue Tax (PEMEX): 30% Income Tax (certain subsidiary companies): 30%	Flat Rate Business Tax (IETU) (certain subsidiary companies): 17.5%	Mining duties. Hydrocarbons duties. Special Production and Services Tax (IEPS gasoline) Merchandise Import Duty	PEMEX (hydrocarbons)
Peru (mining)	1%-12% on operating profit	Income tax: 30%	Dividends and profit distribution: 4.1%	Special Mining Tax (IEM): 2% - 8.4% and Special Mining Levy (GEM): 4% -13.12% (on operating profit)	
Trinidad and Tobago (oil)	10% on domestic sales and 12.5% on sales abroad	Profit tax: 50% of profits obtained from oil production	Additional tax on crude oil sales (the rate varies with the oil price) Green Fund Tax: 0.1% of gross income	Additional tax on oil production Unemployment tax: 5% of profits obtained from oil production	Petrotrin (hydrocarbons)
Venezuela (Bolivarian Republic of) (oil)	30% of the value extracted	Tax on oil revenue (ISLR): 50%		Tax on exceptional prices. Extraction duty Export Record Tax	PDVSA (hydrocarbons)

Source: Economic Commission for Latin America and the Caribbean (CEPAL), on the basis of official information from the respective countries.

[a] The 25% additional tax on exceptional profits (Surtax) was repealed by Hydrocarbons Law No. 3058 and replaced by YPFB participation in the new operating contracts.

[b] Following amendment of the Hydrocarbons Law, the oil contracts are renegotiated and a clause stipulates that the State receives 100% of any increase in the oil price, so the tax on exceptional earnings no longer applies.

C. Value added tax has consolidated but not uniformly

Before the period of booming commodity prices, one of the key features of Latin American tax policy was the increasing share of general taxes on goods and services in the region's total tax revenue, particularly since VAT was introduced in most countries in the 1970s and 1980s. While VAT was originally conceived as away of compensating for the reduction in duties levied on foreign trade, it has since become the leading revenue-earner in most countries.[7] Following the introduction of VAT, most of the increase in the percentage share of taxes of this type of occurred in the 1990s, as a result of reforms that expanded the tax base and raised the general rate of the tax, particularly in the region's lowest tax-burden countries.

The increased importance of VAT made up for the reduction in the relative share of selective taxes and those charged on international trade (see table I.4). The levels and dispersion of import tariffs were reduced; and the export duties that had been in force in many of the region's countries, basically charged on primary production, were suppressed (Barreix, Bès and Roca, 2010). This resulted in a sharp and progressive fall in the proportion of taxes on international trade.[8]

Table I.4
LATIN AMERICA, THE CARIBBEAN AND OECD: TAX REVENUES BY TYPE OF TAX
(Percentages of GDP)

	Latin America (19 countries)		Group 1		Group 2		Group 3		Caribbean (13 countries)		OECD (34 countries)	
	2000	2011	2000	2011	2000	2011	2000	2011	2000	2011	2000	2010
Total tax revenues (excluding social security)	12.7	15.7	18.6	24.0	12.1	15.2	10.5	11.7	19.3	23.0	26.2	24.7
Direct tax revenues	3.8	5.7	6.0	8.8	3.3	5.6	3.7	3.9	6.8	8.3	14.7	13.5
Income, profits and capital gains	3.2	4.9	4.0	6.2	2.9	5.0	3.4	3.7	6.3	7.7	12.5	11.3
Property	0.6	0.7	1.8	2.3	0.4	0.6	0.2	0.2	0.4	0.4	1.8	1.8
Other direct taxes	0.0	0.1	0.2	0.3	0.0	0.0	0.0	0.0	0.0	0.1	0.4	0.4
Indirect tax revenues	8.6	9.6	12.3	14.9	8.5	9.3	6.4	7.2	12.5	14.6	11.3	11.0
General taxes on goods and services	5.1	6.7	9.6	11.4	4.8	6.4	3.4	4.6	5.4	7.1	6.8	6.9
Specific taxes on goods and services	1.9	1.6	1.9	1.6	2.2	1.9	1.3	1.0	1.0	1.2	4.2	4.0
International trade and transactions	1.5	1.3	0.8	1.9	1.6	1.0	1.8	1.6	5.2	5.4	0.3	0.1
Other indirect taxes	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.6	0.7	0.3	0.1
Other taxes	0.3	0.3	0.2	0.3	0.2	0.2	0.4	0.6	0.2	0.2	0.2	0.2
Social Security	2.7	3.4	6.1	8.0	2.6	3.3	0.9	0.8	...	...	8.9	9.1
Total tax revenues (including social security)	15.4	19.1	24.7	32.0	14.7	18.5	11.4	12.5	...	...	35.2	33.8

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official figures and Organization for Economic Cooperation and Development (OECD), OECD Tax Statistics Database.

7 Sales taxes also serve as the foundation of subnational tax revenues in some countries: in Argentina, for example, the Gross Income Tax (IIBB) at the provincial level; in Brazil, the Services Tax (ISS) levied by the municipalities; and in Colombia, the Industry and Trade Tax (ICA), also attributed to local governments.

8 Argentina is an exception in having re-introduced export duties following the end of the currency-board regime in 2002.

Similarly, thanks to the tax-simplification processes applied in the region's tax regimes, selective taxes on the consumption and production of goods and services played a smaller part in the region's average tax structure, although this type of taxation has staged something of a come-back in recent years, as discussed below. These levies were limited to a small group of products (alcoholic beverages, fuels and tobacco). All of this has meant that for over two decades the average Latin American tax structure has maintained a considerable bias towards indirect taxation, which accounts for about two thirds of total revenue if social security contributions are excluded.[9]

The strengthening of VAT revenue across the region over the last few decades particularly reflects its extension to intermediate and final services (the tax was initially charged almost exclusively on physical goods and a number of final services); and also a progressive rise in the general rate in nearly all countries of the region since the 1980s. From 2000 to 2011, VAT continued to consolidate, and the revenue obtained from general goods and services taxes increased as a proportion of GDP in Latin America (from 5.1% to 6.7% of GDP in this period) and in the Caribbean (from 5.4% to 7.1%). The GDP percentages of taxes of this type are similar in Latin America, the Caribbean and the OECD (see table I.4).

Nonetheless, the intra-regional disparities are greater in the case of general sales taxes. For example, in group 1 countries, with the highest tax burdens, Argentina and Brazil collect over 12 percentage points of GDP from taxes of this type, because, in addition to obtaining substantial revenue from VAT (about 8% of GDP), subnational sales taxes also generate a considerable volume of resources. At the other extreme are countries with the lowest tax burdens (group 3), such as the Dominican Republic, Haiti and Mexico, which collect very low levels of VAT revenue (3.5%, 3.8% and 4.2% of GDP for 2011, respectively). In addition, the trend is for direct taxes to strengthen (as a percentage of GDP) in the region's higher-taxation countries (groups 1 and 2) .

The rise in the VAT rate has been consistent with international tax trends, for the average general rate is now about 18.5% in most OECD countries. Despite the rising trend in general VAT rates across the region, rates vary widely between countries. Argentina (21%), Brazil (20.5%),[10] Chile (19%) Peru (18%) and Uruguay 22%) have the highest VAT rates in Latin America (at the same level as the OECD's European member countries), although below Scandinavian countries, which maintain general rates of around 24%). Nonetheless, there is a significant disparity in relation to other countries in the region, including some Caribbean countries that have recently introduced reforms to this tax, generally with rates of between 12% and 17%, in addition to the special cases of Paraguay (10%) and Panama (7%) (see table I.5).

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9 Nonetheless, this characteristic is far from being exclusive to Latin America. Hines and Summers (2009) show that while small countries tend to rely more heavily on consumption taxes than more developed countries, the globalization process will result in all countries becoming like small open economies, so the worldwide use of this type of tax is likely to increase in future years, with the major distributive consequences that this implies.

10 In Brazil, the average effective rate corresponds to the state-level Goods and Services Sales Tax (ICMS),. The final rate varies from state to state, as legislated in each case (according to figures obtained from ECLAC's CEPALSTAT database).

Table I.5

LATIN AMERICA AND OECD COUNTRIES: TREND OF THE GENERAL VAT RATE

(Percentages)

Country	Year of introduction	Initial rate	1992	2000	2011
Argentina	1975	16.0	18.0	21.0	21.0
Bolivia (Plurinational State of) [a]	1973	10.0	14.9	14.9	14.9
Brazil [b]	1967	15.0	20.5	20.5	20.5
Chile	1975	20.0	18.0	18.0	19.0
Colombia	1975	10.0	12.0	15.0	16.0
Costa Rica	1975	10.0	8.0	13.0	13.0
Dominican Republic [c]	1983	6.0	6.0	8.0	16.0
Ecuador	1970	10.0	10.0	12.0	12.0
El Salvador	1992	10.0	10.0	13.0	13.0
Guatemala	1983	7.0	7.0	10.0	12.0
Honduras	1976	3.0	7.0	12.0	12.0
Mexico	1980	10.0	10.0	15.0	16.0
Nicaragua	1975	6.0	10.0	15.0	15.0
Panama	1977	5.0	5.0	5.0	7.0
Paraguay	1993	10.0	...	10.0	10.0
Peru [d]	1976	20.0	18.0	18.0	18.0
Uruguay	1987	21.0	22.0	23.0	22.0
Venezuela (Bolivarian Republic of)	1993	10.0	...	15.5	12.0
Latin America		11.1	12.3	14.4	15.0
Canada	1992	7.0	7.0	7.0	5.0
Denmark	1967	15.0	25.0	25.0	25.0
France	1968	20.0	18.6	20.6	19.6
Germany	1968	11.0	14.0	16.0	19.0
Italy	1973	12.0	19.0	20.0	20.0
Japan	1989	3.0	3.0	5.0	5.0
Spain	1986	12.0	13.0	16.0	18.0
United Kingdom	1973	8.0	17.5	17.5	20.0
OECD-34		15.4	16.3	17.8	18.5

Source: Organization for Economic Cooperation and Development (OECD)/Economic Commission for Latin America and the Caribbean (ECLAC)/Inter-American Centre for Tax Administrators (CIAT), "Estadísticas tributarias en América Latina 1990-2010", OECD Publishing, 2012; OECDStats Database; and P. Shome, "Trends and future directions in tax policy reform: a Latin American perspective", *Bulletin for International Fiscal Documentation*, vol. 46, September 1992 .

[a] Tax rate calculated on an "outside" basis.

[b] Average effective rate of the Goods and Services Sales Tax (ICMS), the value of which varies from state to state, as legislated in each case.

[c] A rate increase of 18% was approved in 2012.

[d] Rate in force as from 1 March 2011 (Law No. 29.666).

The VAT tax base also varies between countries. According to González, Martinoli and Pedraza (2009), Latin America tends to have more exemptions and differential treatments than those prevailing in OECD countries. Apart from the application of a zero rate for exports (respecting the destination criterion), together with some degree of regional consensus to exempt education, cultural, financial and insurance services, several Latin American countries give various exemptions to food products and medicines (whereas developed countries tend only to set lower rates), and also for certain services such as medical care, drinking-water supply, and passenger transport.

The Bolivarian Republic of Venezuela, Colombia, Costa Rica, Ecuador and Nicaragua are among countries with the largest number of VAT-exempt transactions, with Mexico being the paradigm case: its zero-rating of food products, medicines and a wide range of goods and services seriously erodes the tax base. This VAT treatment is the main category of tax expense

in that country, amounting to some 1.13% of GDP in 2011-2012 according to the Ministry of Finance and Public Credit (SHCP), but to about 2.5% of GDP according to the study by Fuentes Castro and others (2011) commissioned by the Tax Administration Service (SAT).[11]

Even with general rates maintained at their current level, effective VAT revenue in several Latin American and Caribbean countries is considerably less than potential. Based on the total income of the economy, the region's countries collect between 0.33 and 0.68 percentage points of GDP in VAT for each percentage point of the general rate (this is interpreted as the productivity of the tax). In contrast, if only consumption is considered as the tax base, the coefficients (referred to as C-efficiency) are between 0.48 and 0.93 percentage points of GDP, with a regional average of 0.62 (see table I.6). The cases of Mexico and the Dominican Republic have been the extremes where, despite applying a general rate broadly in line with the regional average, relatively low levels of revenue collection combine with a very high private consumption/GDP ratio. The tax reform recently implemented in the Dominican Republic aims to address this problem.

Moreover, as also shown in table I.6, average VAT-productivity coefficients in OECD countries are slightly lower than those of Latin American and Caribbean countries, unlike the case of C-efficiency where the developed countries obtain a higher return from the tax.[12]

The VAT-productivity figures are generally close to the averages obtained in other regions of the world, especially those containing developing countries (Gómez Sabaíni, Jiménez and Rossignolo, 2012). Moreover, VAT-productivity has improved significantly in some Latin American countries, such as Chile, Colombia, Ecuador, Peru and Uruguay.

During the most recent five-year period (2008-2012) the countries of the region continued to reform or amend their VAT regimes in a variety of ways (see table I.7). In some countries, particularly Central American ones (El Salvador, Nicaragua, Honduras and Guatemala), the general rate was not raised but the tax base was expanded by reducing the number of exempted goods and services; or else conditions for obtaining certain exemptions were imposed. The Bolivarian Republic of Venezuela and Mexico increased rates without changing the tax base. Most countries that raised rates tended to reduce the tax base selectively by zero-rating or exempting specific items. This happened in Caribbean countries (Barbados, Saint Lucia, and Saint Kitts and Nevis), and also in Colombia and Panama, where the rate hikes were accompanied by exemptions for certain consumer goods and a number of services. Only in the Dominican Republic were rate hikes combined with a reduction in the number of exempted or zero-rated products. This suggests that the revenue effect is likely to be greater than in the case of the other reforms.

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[11] The differences between the estimations are highly significant, owing to the different statistical sources used, the actual calculation methodology, and the definition of tax expense. The Ministry of Finance and Public Credit estimates tax expenses mainly from information obtained from the National Household Income and Expenditure Survey (ENIGH 2008) together with the tax returns and rulings submitted by taxpayers to the SAT, which are adjusted to take account of evasion for different types of taxpayer. In contrast, the study by Fuentes Castro and others (2010), based on the system of national accounts (SNA 2003), estimates tax evasion (and tax expense as the intermediate result) for various taxes, based on a final-consumption model which assumes 0% ex ante evasion. It has also been argued that the zero-rating of food products and medicines is ineffective as a redistributive mechanism, since lower-income households end up receiving a smaller proportion of the subsidy implicit in this tax expense when it is granted on a general basis (SHCP, 2011).

[12] The private consumption/GDP ratio was calculated from USAID (2011).

Table I.6
LATIN AMERICA AND THE CARIBBEAN AND OECD COUNTRIES: VAT REVENUE AND PRODUCTIVITY, 2010

Country	Revenue		Productivity	C-efficiency
	(percentages of GDP)	(percentages of the total)		
Argentina	7.9	23.5	0.37	0.65
Bolivia (Plurinational State of)	6.5	32.3	0.44	0.71
Brazil	7.5	23.0	0.37	0.60
Chile	7.6	38.7	0.40	0.68
Colombia	5.3	30.7	0.33	0.53
Costa Rica	4.8	23.6	0.37	0.54
Dominican Republic	4.3	33.3	0.27	0.31
Ecuador	6.7	34.3	0.56	0.93
El Salvador	6.7	44.8	0.51	0.52
Guatemala	5.1	41.4	0.42	0.48
Haiti	3.2	27.0	...	...
Honduras	5.5	35.2	0.46	0.56
Mexico	3.9	18.7	0.24	0.26
Nicaragua	7.4	32.2	0.49	0.68
Panama	2.9	16.2	0.57	0.79
Paraguay	6.8	37.9	0.68	0.91
Peru	6.6	37.9	0.35	0.55
Uruguay	8.8	34.9	0.40	0.58
Venezuela (Bolivarian Republic of)	5.5	48.3	0.46	0.87
Latin America (19 countries)	5.9	32.3	0.43	0.62
Antigua and Barbuda	6.7	36.4	0.45	0.83
Bahamas	0.0	0.0	...	...
Barbados	8.3	32.3	0.55	0.89
Belize	8.6	37.1	...	...
Dominica	9.7	37.5	0.64	0.79
Grenada	6.6	36.1	0.44	0.50
Guyana	5.6	25.6	0.35	0.40
Jamaica	4.0	14.7	0.23	0.28
Saint Kitts and Nevis	8.0	36.9	0.47	0.66
Saint Vincent and the Grenadines	7.4	32.2	0.49	0.57
Saint Lucia	3.6	16.1	...	...
Suriname	5.0	17.6	0.50	0.74
Trinidad and Tobago	4.5	28.4	0.30	0.58
Caribbean (13 countries)	6.0	27.0	0.44	0.63
Cuba	16.4	43.5	...	...
Canada	3.7	11.8	0.73	1.31
Denmark	9.8	20.7	0.39	0.80
France	7.0	16.2	0.36	0.62
Germany	7.2	20.1	0.38	0.65
Italy	6.3	14.6	0.31	0.53
Japan	2.6	9.6	0.53	0.91
Spain	5.4	16.7	0.34	0.59
United Kingdom	6.5	18.8	0.37	0.58
OECD (34 countries)	6.6	19.6	0.37	0.75

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organization for Economic Cooperation and Development (OECD)/Economic Commission for Latin America and the Caribbean (ECLAC)/Inter-American Centre for Tax Administrators (CIAT), "Estadísticas tributarias en América Latina 1990-2010", OECD Publishing, 2012; OECDStats Database; and United States Agency for International Development (USAID), "Collecting Taxes Database 2009-2010", Fiscal Reform and Economic Governance Project, 2011.

Note: In the cases of Belize, Cuba and Saint Lucia, the figures correspond to general taxes on goods and services. The values for productivity and C-efficiency are only calculated for countries implementing VAT.

Two countries that did not follow the trends described above were Jamaica and Uruguay. In Jamaica there was a rate cut, but the number of exemptions was also reduced; and in Uruguay the tax base was reduced through exemptions applied to hotel, restaurant and auto-rental services. In that country, exemption was also extended to consumption paid for with credit cards by low-income households. The latter pioneering measure aims to improve the equity

of the system, by no longer exempting basic goods for persons of all income levels, but doing so directly for low-income persons who receive government transfers. Normally, the aim is to correct the regressive nature of VAT by exempting goods and services that have a heavy weight in the consumption basket of lower-income sectors; but this measure provides a greater benefit to those who consume more. A promising alternative, since it is more closely targeted, consists of generalizing the tax base and granting exemptions directly to beneficiaries through fiscal transfers, in an amount calculated on the basis of the average consumption basket and credited electronically on a periodic basis (see Barreix, Bes and Roca, 2010).

Table I.7

LATIN AMERICA AND THE CARIBBEAN (17 COUNTRIES): MAIN REFORMS TO VALUE ADDED TAX, 2009-2012

Country and year(s) of reform(s)	Change of rate	Goods and services included in the tax base	Goods and services excluded from the tax base
South America			
Bolivia (Plurinational State of) (2011)			First phase of marketing for mining cooperatives (zero rate)
Colombia (2012)	Simplification of brackets and new consumption tax (4%, 8% and 16%)		Products in the family shopping basket (zero rate) and Internet connection and access services exempt (2010)
Ecuador (2011-2012)		Financial services included in the tax: 12%.	Hybrid and electric vehicles (zero rate)
Peru (2011-2012)	From 19% to 18%		
Uruguay (2012)			Hotel, restaurant and auto rental services, and sales made using the Uruguay Social Credit Card and BPS contributions
Venezuela (Bolivarian Republic of) (2009)	From 9% to 12%		
Mexico (2010)	From 15% to 16% (from 10% to 11% in the border zone)		
Central America			
El Salvador (2009)		Educational services and defined fiscal credits. New concepts of taxed transfers and taxpayers. 13% withholding of VAT for non-affiliates	Interest of non-domiciled financial institutions, employer contributions to pension fund management companies (AFPs); and the national lottery
Nicaragua (2012)		Public sector procurements. Certain products of the basic shopping basket	Services exports (zero rate)
Panama (2010)	From 5% to 7% and higher rates for tobacco (15%) and alcoholic beverages and accommodation (10%)		Various services and international transport
Honduras (2010-2011)	Higher rates for certain goods and services (telephone services, alcoholic beverages, cigarettes, Internet, cable TV)	Domestic transactions	Reimbursement of the tax on consumption paid for by credit card
Guatemala (2012)		Education centres, exempt taxpayers and defined small-scale taxpayers	Second and third sales of property (now taxed by stamp duty)
Dominican Republic (2012)	From 16% to 18%	Certain products in the basic shopping basket exempt, and phytosanitary products	
Caribbean			
Jamaica (2012)	From 17.5% to 16.5%	Certain consumer products and electricity of enterprises	Electricity consumption by natural persons
Saint Lucia (2012)	New tax, 15% (8% for the hotel sector)		Basic consumer goods
Barbados (2010, 2012)	15% to 17% (8.75% for the hotel sector)		
Saint Kitts and Nevis (2010)	New tax, 17% (10% for the tourism sector)		Basic consumer goods (zero rate) and medical, education, transport services and medicines (exempt)

Source: Economic Commission for Latin America and the Caribbean (ECLAC) on the basis of legislation in the respective country.

In addition to VAT reforms, selective taxes have regained some of their importance over the last five years, especially those charged on cigarettes and alcoholic beverages, and on vehicles and fuels —in the latter cases with a tendency to promote environmental sustainability. Thus, several countries raised the tax take (through higher rates or changes in the tax base) in the case of alcoholic beverages and cigarettes (Chile, Dominican Republic, El Salvador, Guatemala, Honduras and the Plurinational State of Bolivia). In other cases vehicle taxes were also increased (Uruguay, El Salvador, Honduras and Guatemala), often pursuing environmental criteria. The latter were more explicit in the case of Ecuador, where taxes on hybrid or electric vehicles were lowered, a new environmental tax on vehicle pollution was introduced, and the environmental tax on plastic bottles was increased; or in Peru, which started to charge a fuel duty to take account of its toxicity, while lowering the tax charged on natural gas; and in Panama, where a surcharge (eco-tax) was levied on used vehicles.

D. Partial strengthening of income tax

A recent development, since the turn of the century, has been the growth of revenue obtained through taxes on income and capital earnings (mainly income tax), which have consolidated as the second pillar of the region's tax system, and has tended to make the regional tax system more progressive over the last decade. Income tax in Latin America (simple average) grew from 3.2% of GDP in 2000 to 4.9% in 2011, whereas in the Caribbean it increased from 6.3% to 7.7% of GDP (see table I.4).[13] This has been achieved by the partial expansion of the bases of taxes charged on services, the application of minimum taxes or contributions, more effective control the taxpayer universe and, in some countries, the appropriation of larger revenues obtained from the production and exportation of commodities.

Unlike the behaviour of the general VAT rate, and in line with international trends, the average maximum marginal rate of personal income tax fell from 49.5% in 1980 to 29.1% in 2000, with a further slight decline to 28.1% in 2011. In some extreme cases, personal income tax was abolished for several years (Uruguay in 1974 and Paraguay in 1992), whereas a flat rate was adopted in others (the Plurinational State of Bolivia at a 10% rate, later raised to 13%, and in Colombia at 35%, before a progressive rate scheme was adopted as from 2008). In addition, the simplification of corporate income tax led to convergence with the general rates applied to legal entities, with the regional average amount of those taxes falling from 43.9% in the 1980s to 28.6% in 2000, with a further slight fall in recent years to an average of 26.2% in 2011 (Cornia, Gómez Sabaíni and Martorano, 2011).

[13] Contributions to the funding of social security systems, which are not analysed in this report, have maintained their share of average total contributions (tax and social security) in Latin America at 17%-18% of the total, without major fluctuations; but as a proportion of GDP they increased from 2.7% to 3.4% (see table I.4). Variations between individual countries are considerable in this area, including differences relating to the public or private provision of services.

Historically, four factors have restricted the growth of income tax. Firstly, most countries have maintained a legal regime for collecting income tax that is clearly biased towards legal entities compared to private individuals. This has serious distributive implications because, under a plausible combination of assumptions on structures and market power, the income tax paid by corporations could be less progressive than personal income tax, owing to the potential for shifting the tax on to prices, and also because more exemptions are available. Moreover, the possibility of being subject to the lower rates applicable to companies, or of obtaining larger exemptions, creates incentives for private individuals not to register in the regime that legally applies to them, but to do so in companies.

Secondly, several countries have maintained a long list of exemptions and exceptions according to the generating source, particularly in the sphere of capital income (Cetrángolo and Gómez Sabaíni, 2007). Thirdly, as shown by Barreix, Bès and Roca (2012), minimum exempt income allowances are currently higher in the region than elsewhere in the world and, in particular, compared to the OECD countries, where the amount is equivalent on average to just over 0.2 times per capita GDP.[14] Fourthly, income tax in Latin American countries has typically been organized on a "schedule" basis, which has meant taxing separately different types of income received by the same taxpayer (income from wage earning employment, interest received on deposits, share dividends, and so forth).[15]

This group of problems has meant that a large proportion of income tax generally falls on the incomes of wage earners, with little revenue impact. Nonetheless, progress has been made in recent years despite the shortcomings noted above. The income-tax reforms introduced in Latin America and the Caribbean have been more numerous in recent years (2007-2012) than in the past, although with different coverage or depth (see table I.8). These reforms display five key features.

[14] Barreix, Garcimartín and Velayos (2012) add that, between those totally exempt from income tax and those who pay the top rates, are most of the taxpayers (few in number) to which intermediate rates are applied. The fact that these tax rates are clearly lower in Latin America than in the average of middle-income countries leaves considerable scope for increasing revenue from the tax.

[15] This type of taxation is contrary to horizontal equity since taxpayers with the same overall level of income could pay different amounts of income tax if the proportion of the schedules and rates charged in each case are different. Moreover, vertical equity is also breached, because in the case of a taxpayer whose total income is such that he/she should be located in a higher bracket of the progressive tax scale, when the income is divided between the different schedules, the appropriate bracket could be lower, and the taxpayer would end up paying a lower or similar rate to that paid by someone with a smaller global income.

Table I.8

LATIN AMERICA AND THE CARIBBEAN (17 COUNTRIES): MAIN REFORMS TO VALUE ADDED TAX, 2009-2012

Country and year(s) of reform(s))	Change of rate	Expansion of the tax base	Reduction of the tax base	Minimum tax	International taxation
South America					
Bolivia (Plurinational State of) (2007)	CIT: Additional rate for mining 12.5%	Tax base expressed in Housing Development Units (UFVs) instead of US$	Mining royalty credited against corporate profits tax (IUE) (in the event of low prices)		
Chile (2012)	CIT: 20% (permanent increase) PIT: lowering of marginal rates, except in highest bracket		Tax credit for education expenditure (up to a certain amount)		Adaptation of transfer price TP regulations. Abolition of income tax on services performed in Chile by Chileans living abroad. Exemption from additional tax for payments for software abroad
Colombia (2012)	CIT: from 33% to 25%, new tax (CREE) with a rate of 9% (8% as from 2015)			National alternative minimum tax and simple alternative minimum tax	Adaptation of TP regulations
Ecuador (2007, 2010-2012)	PIT: from 25% to 35% (top rate and new brackets) CIT: from 25% to 22% (in 2013)	Abolition of a lower rate for financial institutions.	Exemption for certain new investments. Additional deductions; for new workers and for vehicle purchase	New single income tax for banana production activity (2% on gross sales)	
Paraguay (2012)		New PIT: rates of 10% and 8%			
Peru (2007, 2012)		Abolition of exemptions on interest and capital gains. Expansion of the tax to cover dividends			Adaptation of TP regulations. New regulations on foreign controlled companies
Uruguay (2007, 2012)	PIT: from 25% to 30% (top rate)	Income from work: progressive rates Income from capital: proportional rate			
Mexico (2007, 2010-2012)	CIT: from 28% to 30% (temporary, will drop to 28% between 2014-2015)			Single rate business tax: 17.5%	
Central America and Dominican Republic					
Dominican Republic (2012)	CIT: from 29% to 27% (2013-2015)	Tax on dividends (incl. free zones) Resident interest: 10%. Limit on deduction of interest and education expenses	PIT: increase in minimum exempt level		Adaptation of TP regulations. Review of exemptions for nonresidents
El Salvador (2009, 2011)	PIT: from 25% to 30% (effective rate, last bracket) CIT: from 25% to 30% (top rate)	Limit on exemptions for interest and capital gains Abolition of exemption for securities Limit on personal deductions Profit distribution: 5%	PIT: increasing the minimum exempt level and amendment of brackets	New minimum tax: 1% on gross income	IR non-domiciled: from 25% to 30% Adaptation of TP regulations. Under-capitalization rules

Country and year(s) of reform(s))	Change of rate	Expansion of the tax base	Reduction of the tax base	Minimum tax	International taxation
Guatemala (2009, 2012)	CIT: from 31% to 25% PIT: from 15%-31% to 5%-7% (reduction in rates and brackets)	Income and capital gains: 10%, except dividends at 5% Abolition of VAT credit for wage earners New regulations on deductible costs and expenses	PIT: increase in minimum exempt level for wage earners	Creation of the solidarity tax	Adaptation of TP regulations. Rates for nonresidents: 3%, 5%, 10%, 15% and 25%
Honduras (2010, 2011, 2012)	Temporary solidarity contribution: from 5% to 10% (until 2015) Certain categories: from 10% to 25% (movable or immovable property, mining, royalties)	David ends, capital gains, rental and surpluses of educational institutions: 10% Conditions for deductions	PIT: increase in minimum exempt level		Adaptation of TP regulations levelling of rates for non-domiciled: 10%
Nicaragua (2010, 2012)		Dividends and interest: 10%. New classification of taxable incomes (work, economic activities, capital, etc.)	PIT: increase in minimum exempt level	Change of base for banking entities: replaces all deposits by gross income (1%)	Labour income of nonresidents: 20% Adaptation of TP regulations. Definitive withholding for nonresidents: 15%
Panama (2009-2010, 2012)	CIT: from 27.5% to 25% and from 30% to 25% for certain sectors. PIT: from 7%-27% to 15%-25% (reduction in rates and brackets)	Dividends: 10%; in special regimes: 5% Repeal of deductible expenses in reduction of deductions for PIT	PIT: increase in minimum exempt level Exemption from ISR for agricultural or agribusiness activity with a certain income level		Adaptation of TP regulations (restricted to countries with a double-taxation agreement)
Caribbean					
Jamaica (2012)	CIT: from 33.3% to 25% (except regulated firms: 33%)	Dividends of residents: 5%			
Guyana (2011)	CIT: from 45% to 40% (commercial enterprises) and from 35% to 30% (non- commercial enterprises)		PIT: increase in minimum exempt level		
Cuba (2012)		PIT: New tax planned (15%-50%, progressive rates) CIT: New tax 35% (50% for natural resources and 1%-9% of gross income in special cases) Special regimes: non-agricultural cooperative sector (10%-45%, progressive rates)	PIT: deductible expense up to 10 % of income	Agriculture sector: 5% of sales to suppliers or traders	Nonresidents: 15%

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of legislation of the respective countries; and A. Izquierdo and O. Manzano (coords.), *El mundo cambió: ¿cambiará el crecimiento en Centroamérica?*, Washington, D.C., Inter-American Development Bank, 2012; L. Castro, V. Aguiar and M. Sáenz, "Análisis de la reforma tributaria en el Ecuador. Período: 2001-2012", Santiago, Chile, ECLAC, 2013, unpublished; A. Escalante, "Impactos de las reformas recientes de política fiscal sobre la distribución del ingreso: el caso del Perú", Santiago, Chile, ECLAC, 2013, unpublished; T. Genuzio, "Impactos de las reformas recientes de política fiscal sobre la distribución del ingreso en Bolivia", Santiago, Chile, ECLAC, 2013, unpublished; Central American Institute for Fiscal Studies (ICEFI), "Reformas fiscales en América Latina", 2013, unpublished.

Note: CIT (Corporate income tax); PIT (Personal income tax); TP (Transfer prices).

Firstly, in several countries (Chile, Peru, Ecuador, El Salvador, Honduras, Mexico, the Plurinational State of Bolivia and Uruguay) there has been a tendency to raise rates (for firms or natural persons) or to set additional income tax rates. Some countries have also lowered rates (Panama, Guatemala, Guyana, Jamaica, Nicaragua, Dominican Republic), albeit with a clear tendency to expand the tax base to more than compensate the revenue effect of the rates cut.

Secondly, and consistent with the above, most of the reforms, both in Central America and in South America, expanded the income-tax base. In several cases, taxation has been extended to cover all labour income and capital income, including dividends, either because it was not required for the economy as a whole or because certain sectors were excluded (as was the case in Colombia, Dominican Republic, Peru, El Salvador, Nicaragua, Panama, Guatemala and Jamaica).

Although the extension of certain exemptions or allowed deductions (Chile, Panama), or the increase in the minimum exempt allowance in several countries (Guatemala, Nicaragua, Panama), reduced the income-tax base, the establishment of minimum taxes and the reduction of exemptions (most cases) or a more precise definition of deductible expenses to reduce their scope, has led to an expansion of the tax base. The abolition of a long list of exemptions and personal deductions which, far from providing benefits, caused large income-tax losses, has made it possible to reduce the average level of income tax exemptions from 2.3 times per capita GDP in 2001 to roughly 1.5 times per capita GDP in 2011 (see table I.9).[16]

Table I.9

LATIN AMERICA (SELECTED COUNTRIES): INCOME LEVELS AT WHICH MINIMUM AND MAXIMUM INCOME TAX RATES ARE APPLIED

(Number of times per capita GDP)

	Application of minimum ISR rate (exemption level)			Application of top marginal ISR rate		
	1985	2001	2010	1985	2001	2010
Argentina	0.8	1.4	0.3	21.4	16.5	3.7
Bolivia (Plurinational State of)	1.0	…	0.2	10.1	…	0.2
Brazil	0.3	1.5	1.1	10.1	3.1	2.7
Chile	0.2	0.1	1.0	2.8	1.2	11.2
Colombia	0.0	4.1	2.8	20.5	16.6	10.7
Costa Rica	1.2	0.8	1.9	1.4	3.7	2.9
Dominican Republic	1.1	2.3	1.8	413.5	5.8	3.8
Ecuador	0.4	2.4	2.2	29.2	8.3	22.3
El Salvador	…	1.2	0.4	171.7	11.0	3.4
Guatemala	0.9	5.0	1.6	356.0	22.5	14.4
Honduras	0.0	3.6	2.9	600.4	36.0	13.1
Mexico	0.7	0.1	0.5	21.3	44.0	3.4
Nicaragua	1.7	7.7	2.1	56.9	61.2	20.7
Panama	0.3	0.9	1.4	89.0	57.8	4.1
Peru	…	2.9	1.7	…	22.3	14.7
Uruguay	…	…	0.7	…	…	10.3
Venezuela (Bolivarian Republic of)	…	0.0	1.5	…	0.0	12.7
Latin America	**0.7**	**2.3**	**1.4**	**128.9**	**20.7**	**9.1**

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of J. Stotsky and A. WoldeMariam, "Central American tax reform: trends and possibilities", *IMF Working Paper*, No. 02/227, 2002; and A. Barreix, C. Garcimartín and F. Velayos, "El impuesto sobre la renta personal: un cascarón vaciado", *Desarrollo en las Américas: el futuro de los impuestos en América Latina y el Caribe*, Washington, D.C., 2012, forthcoming.

[16] In some countries of the region, such as Argentina, this was also due to real GDP growth and the fact that the nominal parameters governing the tax were not adjusted for inflation.

In addition, over the last two decades and with few exceptions, the tax base has been expanded by lowering the income threshold at which the top marginal rate is charged. In the case of corporate income tax, several countries have also made progress by reducing tax incentives granted in the framework of economic promotion regimes (free zones).

This has been reinforced by the establishment or amendment of minimum corporate income taxes in several countries (Mexico, Colombia, El Salvador, Honduras and Nicaragua) over the last few years, which has made it possible to strengthen the collection of income-tax revenue and tighten control over tax evasion. Gómez Sabaíni and Jiménez (2011b) provide thorough details of the application of minimum taxes in the region, as they existed in 2010 (see table I.10). In Argentina, a minimum tax is applied to the value of gross assets, under the assumption that capital mobility is a substitute for corporate income but protects revenue in inflationary settings. Capital or net assets are also widely used in Colombia, Ecuador, Panama and Uruguay, although at different tax rates. Guatemala applies the Solidarity Tax which is charged at a 1% rate on net assets or a gross income, whichever is larger. Mexico is a special case, where from 2008 onwards, income tax based on the company's gross assets (assets tax or IMPAC) has been replaced by a tax inspired in the "flat tax", which is a minimum single-rate tax modality, known as the flat-rate business tax (IETU).

Table I.10

LATIN AMERICA: MINIMUM INCOME TAXES, 2010

Country	Tax (rate and base)
Argentina	1.0% on gross assets
Bolivia (Plurinational State of)	No
Brazil	No
Chile	No
Colombia	3% on net capital
Costa Rica	No
Dominican Republic	1.0% on assets
Ecuador	0.15% on net capital [a]
El Salvador	1.0% on gross income
Guatemala	1% on 25% of net assets or 25% of gross income, whichever is greater (solidarity tax)
Honduras	1.0% on assets
Mexico	17.5% on taxable income (cash flows)
Nicaragua	1.0% on gross income
Panama	Alternative income-tax calculation (CAIR): 25% on the larger of net taxable income and 4.67% of gross taxable income (1.4% of gross income) [b]
Paraguay	No
Peru	0.4% on net assets [c]
Uruguay	1.5%-3.5% on net capital
Venezuela (Bolivarian Republic of)	No

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of P. Gutiérrez and others (eds.), *Global Corporate Tax Handbook 2010*, Amsterdam, IBFD, 2010.

[a] While the tax base consists of real-estate property, the tax is not conceived as a property tax but as an additional tax on corporate earnings.

[b] This tax takes the form of a business licence; its maximum amount is 20,000 balboas per year.

[c] Although the Temporary Tax on Net Assets (ITAN) is not a definitive minimum tax, it is during the current fiscal year because its surpluses are repayable as a tax credit.

Thirdly, most reforms have included new or revised international taxation regulations, most of which would apply to transfer prices, although some also included regulations on tax havens and non-residents.

The most recent reforms also display two relatively new features. Firstly, several of them have been inspired in the dual income tax implemented in Scandinavian countries, and pioneered

in the region by Uruguay. Since July 2007, Uruguay has taxed different types of incomes labour separately, charging progressive rates ranging from 10% to 25% (rising to 30% in 2012) on labour income, and a proportional 12% rate on capital income, except for dividends which pay 7% (Barreix and Roca, 2007). On this point, the reintroduction of personal income tax in the Uruguayan tax system considerably improved revenue and distributive equity.

Peru has also incorporated a number of elements of dual income taxation since 2009; in addition to applying progressive rates (ranging from 15% to 30%) on labour income, capital income was taxed at a proportional rate of 6.25% (on 80% of the taxable amount). Exceptions were dividends, which are subject to a 4.1% rate, and also interest on bank savings and deposits by private individuals, which have been exempt since 2010.

Following the international crisis of 2008, the Dominican Republic and several Central American countries (El Salvador, Guatemala, Honduras, Nicaragua and Panama) passed tax reforms along the same lines, setting flat rates of between 10% and 15% on capital income (with exceptions for income received by non-residents), combined with higher rates for business profits and progressive rates for labour income —a situation consistent with the Uruguayan version of the dual income tax (ICEFI, 2011). Progress made in Central America and the Dominican Republic, and also reform in Jamaica, have reflected a combination of increasing revenue needs, and, in contrast to other countries in the region, limited revenues from the exploitation of natural resources.[17]

The other relatively innovative feature of income tax is an emerging trend to turn it into a tool that promotes formal employment. This is particularly clear in the case of the income-tax reform introduced in Colombia (2012). Firstly, the measures adopted included a cut in payroll taxes from 29.5% to 16%, by eliminating contributions to the National Apprenticeship Service, the Colombian Family Welfare Institute (ICBF) and contributions to the Social Security in Health system. Secondly, to finance these items, a new tax, the Business Contribution for Equity (CREE), will tax 9% of business profits on a basis that excludes deductions for fixed assets (the rate will drop to 8% after 2015). While the first measure is expected to reduce the tax cost of employing workers, the new tax weighs more heavily on firms with large amounts of fixed assets. The two measures together help to redistribute the tax burden away from firms in more labour-intensive sectors towards those that are more capital-intensive, particularly the mining sector. The income-tax reforms implemented in El Salvador and Guatemala encourage formal employment, by making only the pay of workers affiliated to social security deductible.

Although some of these factors are still too recent to show through in an increase in the tax burden, they have helped to grow income-tax revenue, particularly since 2002, and maintain its position as the second most important tax in Latin American tax structures. Nonetheless, there is a persistent imbalance in the structure of income tax, in terms of the legal regimes applicable to legal and natural persons, resulting in weak revenue flows from personal income tax. This is arguably the most significant and worrying difference between Latin American tax systems and those prevailing in developed countries.

[17] These taxes tend to arouse vigorous opposition in certain social sectors, generally business groups, with actions that include appeals for rulings of non-constitutionality, which have either undermined the respective initiatives (Honduras, Guatemala) or have prevented them from being passed by the legislature (Costa Rica).

E. Taxation of property remains chronically weak, but taxes on financial transactions have gained ground

Taxes on capital, particularly real estate, can generate a relatively stable flow of tax revenues and involve low compliance and tax administration costs. Moreover, as property registry values are kept systematically up to date, this type of tax can be an instrument for stabilizing real estate prices —an important quality given the potential for speculative bubbles to develop in this market (European Commission, 2012).

Nonetheless, the revenue obtained from capital taxes has historically been very small in Latin American countries. Table I.11 shows data on revenues associated with these taxes for 2010, giving details of the different types of capital taxes levied. The average revenue obtained from capital taxation by 15 Latin American countries is equivalent to 0.83% of GDP, which is less than half of the average in the 34 OECD countries (1.77% of GDP). Nonetheless, this gap between the two groups of countries conceals two significant differences in relation to these taxes.

Table I.11

LATIN AMERICA AND OECD COUNTRIES: REVENUE STRUCTURE OF CAPITAL TAXES, 2010

(Percentages of GDP)

Country	Real-estate property	Net wealth	Inheritances and grants	Financial and capital transactions	Non-recurrent	Other recurrent	Total capital taxes
Argentina	0.35	0.36	...	2.31	...	...	3.02
Brazil	0.42	...	0.06	0.82	...	0.55	1.85
Chile	0.50	...	0.04	0.18	...	...	0.71
Colombia	0.58	0.36	...	0.59	...	...	1.54
Costa Rica	0.25	...	...	0.08	...	0.01	0.33
Dominican Republic	0.18	...	0.01	0.45	0.03	...	0.67
Ecuador	...	...	...	...	...	...	...
El Salvador	...	...	...	0.08	...	...	0.08
Guatemala	0.19	...	...	0.00	...	...	0.19
Mexico	0.20	...	...	0.10	...	...	0.30
Panama	0.40	...	...	0.11	...	0.28	0.79
Paraguay	0.29	...	...	0.02	...	0.00	0.31
Peru	0.20	...	...	0.32	...	...	0.52
Uruguay	...	1.13	...	0.17	...	0.04	1.34
Venezuela (Bolivarian Republic of)	...	...	0.02	...	...	...	0.02
Latin America-15	0.32	0.23	0.02	0.37	0.01	0.10	0.83
Canada	3.13	0.09	...	0.16	0.19	...	3.58
Denmark	1.37	...	0.22	0.33	...	...	1.92
France	2.47	0.23	0.40	0.56	...	...	3.65
Germany	0.45	...	0.18	0.21	...	...	0.84
Italy	0.62	0.14	0.03	1.10	0.06	0.10	2.05
Japan	2.13	...	0.26	0.29	...	...	2.69
Netherlands	0.70	0.00	0.29	0.47	...	...	1.47
Spain	0.88	0.01	0.23	0.76	0.16	0.01	2.05
United Kingdom	3.40	...	0.18	0.62	...	...	4.20
United States	3.03	...	0.14	...	...	...	3.17
OECD-34	1.05	0.16	0.12	0.42	0.02	0.01	1.77

Source: Economic Commission for Latin American and Caribbean (ECLAC) on the basis of Organization for Economic Cooperation and Development (OECD) OECDStats database.

Firstly, account needs to be taken of the different composition of this type of taxation. In Latin America, about half of the average amount of tax revenue comes from taxes on financial and capital transactions (including the tax on financial transactions in recent years); another large share (38.5%) corresponds to recurrent taxes on real-estate property, while the rest encompasses other capital taxes, mostly levied on wealth or net capital (although these are only in force in three Latin American countries).[18] In contrast, among OECD countries, the tax on real-estate property predominates, followed by transaction taxes and, far behind, taxes on net capital (assets), inheritances, legacies and grants (widely distributed).

Secondly, there are large differences between countries in both Latin America and the OECD. In terms of taxes on financial and capital transactions, Argentina has the highest revenue level in the region, broadly matching the situation of Spain and Italy among developed countries. In taxes on real-estate property, the differences are even greater among OECD member countries (see table I.11), although they are generally above their Latin American peers in revenue terms.

The low operational capacity of local-government tax administrations in Latin America has weakened capital taxation. In many cases, revenue collection and charging of tax on real-estate property is impaired by poor coverage of the cadastral register, high arrears rates, and substantial undervaluation of properties owing to the systematic lack of adequate updating of cadastral values. The causes of the high arrears rates are many: in particular, lack of information for making payments, lack of payment facilities, perceived low risk for those who fail to comply with their tax obligations, and lack of information and transparency in the use of the revenues.

Another obstacle faced by capital taxation, especially taxes on real estate, is its high visibility. In several countries, to alter the cadastral values of land plots and the tax value of real-estate property municipalities require legal authorization from state or provincial congresses. But these do not have incentives to increase the land valuation tables, because citizens, particularly in capital cities, perceive the increases as unjustified, which makes them very unpopular political decisions. The high visibility of the tax generates strong political pressure which often leads to tax benefits, such as exemptions, preferential treatment and amnesties being granted, together with rates cuts or the maintenance of undervaluation —all of which serve to erode the tax base and reduce its progressiveness and ultimate redistributive impact.

In contrast, the taxation of financial transactions, which goes under different names in different countries, has been growing in importance internationally over the last two decades, as shown in table I.12. While in 1996 only one country in the Asia-Pacific region (Australia) applied this tax, by 2005 there were a total of 13, of which eight were Latin American. Most of these countries have kept these instruments in force, in particular Argentina, Brazil, Colombia and Peru (Coelho, 2009) and, more recently, Mexico with a tax imposed on cash deposits, and a tax in Panama also charged on financial transactions.

[18] In several of the region's countries, net assets are also used as a basis for minimum income-tax taxes (see table I.10) —another example of heterodox taxation.

Table I.12
LATIN AMERICA AND ASIA AND THE PACIFIC: NUMBER OF COUNTRIES WITH TAXES ON FINANCIAL TRANSACTIONS

Year	Latin America	Asia and the Pacific	Total
1996	1	0	1
1997	1	1	2
1998	1	1	2
1999	1	4	5
2000	1	3	4
2001	1	3	4
2002	2	4	6
2003	3	4	7
2004	4	6	10
2005	5	8	13
2006	4	7	11
2007	4	7	11
2008	3	6	9
2009	2	6	8

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of I,. Coelho, "Taxing Bank Transactions. The Experience in Latin America and Elsewhere", paper presented at the Third International Tax Dialogue (ITD) Conference, Beijing, October 2009.

Financial transaction taxes have proven suitable for obtaining large revenues in the short run, albeit with variations from country to country. In Argentina, the tax on current-account debits and credits (charged at a 0.6% rate) generated revenue of around 1.8%-1.9% of GDP in recent years; while the tax on financial movements (GMF) in Colombia generated revenue of 0.6% of GDP in 2010. Nonetheless, the yield from these taxes has since diminished in both countries, possibly owing to changes in means-of-payment use patterns. In Brazil the Temporary Levy on Financial Movements (CPMF), which was repealed in 2008, had generated revenue equivalent to 1.4% of the previous year's GDP, while the Financial Transactions Tax (ITF), in force only between 2007 and 2008, produced the equivalent to 0.9% of GDP in 2008 (Coello, 2009). Lastly, the Plurinational State of Bolivia, Peru and the Dominican Republic also apply this type of tax, albeit with less than satisfactory results: in 2010, they generated tax revenue of barely 0.2% of GDP.

F. Subnational government revenue has grown slightly

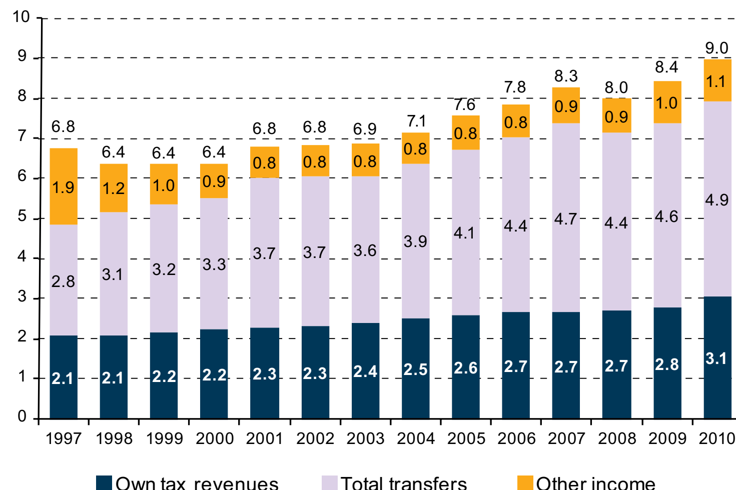
Over the last two decades, Latin America has displayed a strong trend towards decentralization. In federal countries this has involved the partial transfer of federal-government functions to lower levels of government; in unitary states with multiple government levels there has been a significant transfer of functions towards local governments; and, lastly, in traditionally unitary and highly centralized countries, new intermediate levels of government have been created with responsibility for formulating and executing important public policies, or simply managing them (Jiménez and Viñuela, 2004).

Despite the highly heterogeneous nature of these decentralization processes, a common outcome has been a high level of vertical asymmetry in the distribution of spending and incomes between government levels. As shown in figure I.1, although the total fiscal income of these governments has grown considerably over recent years, this is basically due to the growing importance of transfers from central governments rather than larger tax revenues actually generated at the intermediate and local levels. On average, for a group of eight countries of the region, total transfers grew by 2.1% of GDP between 1997 and 2010, while locally generated tax revenues only increased from 2.1% of GDP to 3.1% in the same period.[19]

Figure I.1

LATIN AMERICA (8 COUNTRIES): TREND OF THE STRUCTURE OF TOTAL SUBNATIONAL GOVERNMENTS INCOME, 1997-2010 [a]

(Percentages of GDP)



Source: Economic Commission for Latin America and the Caribbean (ECLAC, on the basis of official figures.

[a] The concept of subnational government refers to the provinces in the case of Argentina; prefectures and municipalities in the case of the Plurinational State of Bolivia; states and municipalities in Brazil; municipalities in Chile; departments and municipalities in Colombia; local governments (cantons) in Costa Rica; provincial and municipal councils in Ecuador; and the states and municipalities in Mexico.

In most countries with some degree of fiscal decentralization, subnational governments rely heavily on the transfer system through which each central government helps finance their expenditure responsibilities, in other words the provision of public goods to its citizens. Brazil is an exception, because subnational governments (states + municipalities) contribute about 28% of total tax revenue (9.1 percentage points of GDP). A second tier of countries includes Argentina and Colombia, where the subnational levels have contributed roughly 15% of total revenue (see table I.13). In other countries, governments have not made much progress on this, and subnational tax revenue represents between 1.5% and 6.2% of the total tax revenue of each country.

[19] For a detailed analysis of the transfer systems applied in each country of the region, see Jiménez and Podestá (2009a).

The taxes most frequently attributed to subnational levels are those levied on property, automobile licences, fees for specific services, and certain municipal charges, in all of which revenue potential is small compared to the tax bases attributed to central bodies, such as VAT or income taxes (OECD/ECLAC/CIAT, 2012). In the countries of the region with the largest tax burden at the subnational level, certain general consumption taxes are also important; and in recent years these have become the main source of locally generated tax resources for the government level in question.

Table I.13

ATTRIBUTION OF TAX REVENUES BETWEEN THE DIFFERENT LEVELS OF GOVERNMENT, 2010

	Central government + social security [a]	State government	Local government	Total	Central government + social security [a]	State government	Local government	Total
	(percentages of GDP)				*(percentages of total revenue)*			
Federal countries								
Argentina	28.7	4.8	…	33.5	85.8	14.2	…	100.0
Brazil	23.3	7.8	1.3	32.4	71.9	23.9	4.1	100.0
Mexico	11.2	0.4	0.2	11.8	94.9	3.4	1.7	100.0
Venezuela (Bolivarian Republic of)	11.4	…	…	11.4	100.0	…	…	100.0
Unitary countries								
Bolivia (Plurinational State of)	19.3	…	0.9	20.2	95.6	…	4.4	100.0
Chile	18.4	…	1.2	19.6	93.8	…	6.2	100.0
Colombia [b]	14.4	0.5	2.4	17.3	83.2	3.1	13.7	100.0
Costa Rica	19.9	…	0.6	20.5	97.0	…	3.0	100.0
Dominican Republic	12.8	…	…	12.8	100.0	…	…	100.0
Ecuador	19.6	…	…	19.6	100.0	…	…	100.0
El Salvador	14.9	…	…	14.9	100.0	…	…	100.0
Guatemala	12.1	…	0.2	12.3	98.5	…	1.5	100.0
Honduras	15.7	…	…	15.7	100.0	…	…	100.0
Nicaragua	22.9	…	…	22.9	100.0	…	…	100.0
Panama	17.7	…	…	17.7	100.0	…	…	100.0
Paraguay	17.2	…	0.8	17.9	95.8	…	4.2	100.0
Peru	16.6	…	0.7	17.4	95.8	…	4.2	100.0
Uruguay	25.2	…	…	25.2	100.0	…	…	100.0

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of Organization for Economic Cooperation and Development (OECD)/Economic Commission for Latin America and the Caribbean (ECLAC)/Inter-American Centre for Tax Administrators (CIAT), "Estadísticas tributarias en América Latina 1990-2010", OECD Publishing, 2012; and CEPALSTAT database for Honduras, Mexico, Nicaragua and the Plurinational State of Bolivia.

Note: The figures exclude local-government incomes in Argentina, the Bolivarian Republic of Venezuela, Costa Rica (until 1997), Dominican Republic, Ecuador, El Salvador, Panama (up to 1998 and 2010), Paraguay (up to 2004), Peru (until 2004) and Uruguay, the since the data are not available.

[a] Income received in the form of social security contributions is assigned to the central-government sphere, because current social security systems are generally managed nationally and, although there might be a subnational regime in some countries the region (e.g. Argentina), the amount of resources involved is marginal, and it is not available for the purposes of this study.

[b] Colombia is constitutionally a unitary state with a decentralized political structure.

In Brazil, sales taxes have been adopted at all three government levels, although this raises difficulties in inter-jurisdictional coordination. In addition to the Industrialized Products Tax (IPI), collected by the federal government, state governments have full taxation powers over ICMS, which is levied on goods and services at all stages, but on a general basis covering a much broader tax base than the IPI. In addition, the municipalities manage and collect the Services Tax (ISS) charged on all service provision stipulated in the legislation and undertaken within the geographic limits of each municipality. In Argentina, the main source of provincial tax revenue is the Gross Income Tax, whereas in Colombia, sales taxes on goods and services also play a key role in subnational financing, particularly the Industry and Trade Tax (ICA) at the municipal level (Gómez Sabaíni and Jiménez, 2011a). Apart from having their revenue generating potential restricted in most of the region's countries, subnational governments find it hard to make the most of the tax powers assigned to them, as shown by the low levels of revenue obtained from land tax.

II. The quest for reciprocity as the political basis for tax reform in Latin America and the Caribbean

A. Political and structural determinants of taxation

As noted by Tanzi (2012), 50 years ago the Charter of Punta del Este establishing the Alliance for Progress included a regional agenda to promote tax reforms, with a view to increasing tax levels and making systems more progressive by expanding the collection of direct taxes. As is well known, these objectives have not been fully achieved, and the challenge therefore remains. Reflecting fiscal consolidation imperatives, fiscal policies in the region in recent decades have been aimed primarily at revenue mobilization, often at the expense of efficiency and equity objectives (Ter-Minassian, 2012). In many of the region's countries, tax collection is still insufficient. Underlying this chronic deficiency are many reasons, known as political economy factors, relating to the impossibility of making significant reforms to personal income tax in the region owing to the multiplicity of sectoral pressures and interests of various social and political stakeholders.

There are various dimensions and approaches to the study of political economy in terms of tax reform. Gómez Sabaíni and Martner (2008) find that widespread income inequality has influenced the design and implementation of the tax system, generating vicious circles of income inequality and tax insufficiency and regressiveness, rather than a virtuous circle that uses the tax system to correct gaping income inequalities.

From the political point of view, social inequality implies the existence of active groups of elites seeking to minimize their relative tax burden, either by controlling the legislative process or ensuring that the legislature adopts tax rules that have that effect. In those circumstances, it becomes more difficult to design progressive structures. What is more, often not only is the redistributive impact of taxes neutralized, but the scope and quality of public goods provision is restricted, which prevents sufficient collection. As pointed out by Schneider (2012), the capacity to collect taxes from the most buoyant sectors of the economy is a reflection of robust institutions and a strong State-society nexus. Obviously, more progressive systems are able to glean contributions from sources such as temporary private income from high commodity prices.

Thus, context is crucial for implementing reforms, as windows of opportunity (Gómez Sabaíni and Morán, 2012) open in times of crisis, electoral change (what is known as the democratic dividend), and even occasionally as a result of international pressure. In any event, citizens' perception of State action is vital to the feasibility of reforms aimed at increasing public revenues.

The tax systems in force are the result of successive compromises arrived at in various circumstances, ranging from the opportunities offered by a crisis situation to the constraints represented by the capacity of the existing institutions to collect taxes. These constraints vary from one country to another and the determinants of each country's tax structure arise out of specific factors and must therefore be considered case by case.

There are several explanations for the low tax burden in Latin America (particularly in Central America, and less so in the Caribbean), compared with levels in developed countries. The main variables influencing levels of tax collection and the efficiency of tax administration are thought to include per capita income, production structure, degree of trade and financial openness, the population's level of education, quality of public institutions, perceived corruption and observance of certain rights.

Countries with higher and more equitable per capita income tend to have a higher level of tax collection from income and consumption, whereas countries with lower per capita incomes have a more uneven structure relying mainly on indirect taxes. Tax income is also negatively correlated with the size of the agricultural sector, which points to the greater difficulty of collecting tax in this sector. On the other hand, some sociodemographic factors (such as education level and population growth rate) may have a positive effect on collection. A more highly educated population should boost tax collection, through both higher personal income and greater tax awareness (Piancastelli, 2001).

The institutional variables affecting tax collection fall into two areas: institutional management efficiency and political processes. Control of corruption, quality of public institutions, governance effectiveness and the quality of tax legislation (Gupta, 2007; Perry, Bustos and Ho, 2011) could have a positive impact on tax systems, while political process variables such as degree of democracy, political stability and the rule of law might have a positive impact on the taxpayer (who is then more likely to respect tax legislation) (Torgler, 2006), and a State's fiscal capacities can be affected by a history of conflict (Besley and Persson, 2008).

In a study carried out for ECLAC, Dioda (2012) offers an updated version of this analysis as it applies to Latin America and the Caribbean as a whole. In keeping with previous research (Thirsk, 1997), the study found that part of the reason for the higher tax burden in the Caribbean is a British and Dutch colonial legacy, in the form of institutions that contributed to stronger oversight of the agricultural sector and the creation of a wide formal labour market, with the resulting positive effects on the tax base. Dioda (2012) also found that the lower tax burden in most Central American countries may be associated with a different colonial legacy and indicators of recent internal conflicts and weak or very recent enforcement of certain political and civil rights (also reflecting the strong influence of certain elites or interest groups with the ability to block reform). The existence of a strongly positive relationship between indicators of political freedom and direct taxation in the region as a whole suggests that the influence of these groups could be particularly significant as regards income tax.

Other estimates performed by ECLAC confirm the positive and significant effects of per capita income on tax revenues, as the variable with the greatest effect on collection levels. The

export sector is also thought to have positive effects on tax collection by virtue of rises in the prices of commodities, the main source of export income in the region. The trend in the fiscal deficit is predictable, as a larger deficit in one year would lead to a greater tax effort the following year.

B. The importance of reciprocity between citizens (taxpayers) and the State for creating a new fiscal policy

From the political economy perspective, regressions show a statistically significant link between the tax burden, on the one hand, and the control of corruption and the quality of regulations on the other. This result is backed up by the positive relationship between level of education and tax revenues, which could be associated with higher incomes and greater tax awareness. It also highlights citizens' perception of the importance of effective States, and is in keeping with opinion polls carried out in various Latin American cities suggesting that the conditions are ripe for implementing fiscal policies based on reciprocity (OECD-ECLAC 2011, p. 85; CAF 2012, p. 205).

As with the econometric results, these surveys conclude (to a statistically significant degree) that most households are willing to pay more taxes in exchange for better public services in terms of health, education and safety, less corruption and a crackdown on tax evasion. This may be seen as evidence of potential to move forward with fiscal policy strategies (or implicit/explicit fiscal covenants) based on proposals to develop this reciprocity by improving the quality of public administration.

ECLAC has suggested that each country possesses, implicitly or explicitly, a basic sociopolitical agreement (a social covenant or contract) that recognizes the obligations and rights of the State and of citizens, but that these social covenants need to be renewed to bring them in line with current reality (ECLAC, 1998). The fiscal covenant in particular may be interpreted as an agreement on the amount, source and destination of resources required by the State, accompanied by transparency and accountability to ensure that the agreement is monitored and enforced.

From a political perspective, the fiscal covenant is based on reciprocity between the State and citizens. However, certain elements can erode such reciprocity. More specifically, there are three types of perverse reciprocity in the region that weaken the potential for reaching comprehensive and sustainable fiscal agreements or covenants. These incomplete forms of reciprocity include: (i) exclusionary reciprocity; (ii) unnecessary reciprocity; and (iii) asymmetrical reciprocity (Fuentes Knight, 2012).

1. Exclusionary reciprocity and informality

Exclusionary reciprocity refers to a situation where large segments of the population have a tenuous or non-existent relationship with the State, and do not see themselves as benefiting from State services. Such groups have no social protection, are marginalized, suffer

disproportionately as a result of insecurity, and are associated with the informal sector. A few decades ago, Hirschman suggested that the degree to which different population groups interact with and are committed to the State depends largely on the State's capacity to implement policies that alter these groups' cost-benefit perception and thereby prevent them from opting out of society (or out of the State-citizen relationship), for instance by engaging in the informal sector (Perry and others, 2007, p. 2, and Hirschman, 1970).

Informal employment has fallen in recent years in many of the region's countries. In contrast to what happened in the 1990s, the region's economy burgeoned between 2003 and 2008; in 2010, it recovered rapidly from the global financial crisis, then posted a slower but still positive growth rate in 2011 and 2012. During this period, there was a rise in wage work covered by social security in most Latin American countries, and formal employment dipped only briefly —by less than GDP— in 2009. The uptrend of the past several years and the moderate fall in 2009 may be at least partly attributable to labour policies that included subsidies for wages or training to offset redundancies during the crisis, broader access to unemployment insurance and a rise in minimum wages (ECLAC-ILO, 2012).

Broader growth-promotion policies may also have boosted formal employment. In Brazil, the surge in formal relative to total employment seems to be the result of universal access to education, as formal employment rose especially sharply among the more highly educated. In addition, a significant rise in access to credit (especially residential mortgages) and the resulting demand for proof of income also acted as an incentive for formal employment (Barbosa Filho, 2012).

Available information suggests a strong correlation between informality and tax evasion (Perry and others, 2007, p. 14; Gómez Sabaíni and Morán, 2012), which is consistent with weak or non-existent reciprocity between the State and citizens in this particular sector of the population. Gómez Sabaíni and Morán (2012) point out that decreasing informality in Latin America in recent years has gone hand in hand with rising tax revenues, mainly from VAT and income tax (which reflects the link between taxation and informality). Gradually decreasing evasion rates (at least in VAT, for which some of the region's countries perform periodic estimates) may also be a reflection of falling informality, although informal work still represents a large proportion of employment in the region. Despite the lack of consensus on the best way to measure informality, several measurements suggest that Latin America is one of the world regions with the highest levels of informality (Gómez Sabaíni and Morán, 2012).

2. Unnecessary reciprocity and weak institutions

What can be termed unnecessary reciprocity occurs when States have weak institutions and much of their income comes from natural resources or certain strategic assets (Moore, 2008; CAF, 2012). This means that the bulk of the budget is not directly financed by the country's citizens. As noted earlier, reciprocity is weak in such cases. As the State has other sources of income, it does not need to establish reciprocity or negotiate with citizens as a group: reciprocity is unnecessary.

According to a study commissioned by the Development Bank of Latin America (CAF) to compare countries around the world in terms of natural resource exports and various fiscal variables, countries that were more dependent on natural resource revenues gave a poorer fiscal performance, although the findings also varied by countries' income levels (CAF, 2012, pp. 239-242). In particular, the study found that natural-resource-dependent countries tended to show lower (adjusted) net savings and worse transparency indices in natural-resource and budget management, as well as poorer indicators for spending on education (measured by primary and secondary enrolment per dollar spent) and health (measured by life expectancy and immunizations per dollar spent).

The study acknowledged that a range of fiscal performance trajectories exist among the Latin American countries, and concluded that the overall results pointed to a link between fiscal dependence on natural resources and less efficient and transparent management by the State (CAF, 2012, p. 243). This confirms the possibility of "unnecessary" or weak reciprocity in such cases.

The above does not mean that the exploitation of natural resources is always negatively correlated with the quality of public administration. Even though revenue from natural resources can give rise to serious conflict and violence, it can also be subject to greater accountability in a context of robust institutions. Hence the distinction between the "curse" and the "blessing" of resources in terms of development (Collier, 2009, pp. 127-8). The rules and funds set up in Chile, Colombia and Peru to help stabilize income from natural resources may represent a step in the right direction, as they contribute not only to improving macroeconomic management, but also to encouraging greater transparency.

Unnecessary reciprocity can also arise where subnational governments are too weak to generate their own tax revenues. Although subnational governments' proximity to citizens could make them more efficient and accountable (Tiebout, 1956), in the region many of them depend on resources from the central government. This dependency is thought to erode the accountability of subnational governments to their citizens in terms of public service provision (Ahmad and others 2005), while their spending may be less efficient than that of governments that collect their own income (Bird and Smart, 2002).

3. Asymmetrical reciprocity and inequality

Reciprocity based on inequality in economic and political power, particularly when there are de facto powers with a veto, may be described as asymmetrical. This is the antithesis of equality and democracy, and in the taxation sphere it is reflected in systems that make no noticeable contribution to equality, tax expenditures that represent largely unjustifiable tax breaks and, sometimes, limitations on the ability of tax administration efforts to collect resources from the highest income groups.

Available evidence suggests that the region's tax systems do not make a clear, direct contribution to equality, although their input into State resources may help to foster equality through spending. Despite the methodological limitations of the studies available, there is some

basic common ground among the findings, which indicate that taxation in Latin America is currently regressive or slightly progressive owing to the prevalence of indirect taxation over direct taxation. More specifically, studies show that the limited share of the most progressive tax[1] (income tax), does not offset the regressiveness in the other taxes based on goods and services (VAT and excise). This bias is further entrenched by the virtual absence of a wealth tax (Gómez Sabaíni, Jiménez and Rossignolo, 2012).

Table II.14 shows that, although in all the region's countries personal income tax has a clearly progressive design (see Kakwani indices), it has a very small effect on income distribution (see Reynolds-Smolensky indices), because it represents too small a share of the tax structure.

Table II.14

LATIN AMERICA (15 COUNTRIES): FINDINGS OF STUDIES ON THE DISTRIBUTIVE EFFECT OF PERSONAL INCOME TAX

Country	Year	Indices			
		Gini pre-tax	Kakwani	Gini post-tax	Reynolds Smolensky
Argentina	2006	0.5133	0.3688	0.5018	0.0115
Brazil	2003	0.6180	0.3063	0.6119	0.0061
Chile	2006	0.5791	0.3886	0.5584	0.0207
Colombia	2004	0.5370	0.3570	0.4590	0.0780
Costa Rica	2004	0.5770	0.3328	0.5692	0.0078
Dominican Republic	2004	0.5106	0.3951	0.4759	0.0347
Ecuador	2004	0.4080	0.4230	0.4040	0.0040
El Salvador	2006	0.5034	0.3247	0.4947	0.0087
Guatemala	2000	0.5957	0.3158	0.5946	0.0011
Honduras	2005	0.5697	0.3303	0.5647	0.0050
Nicaragua	2001	0.5963	0.3478	0.5905	0.0058
Panama	2003	0.6364	0.2439	0.6312	0.0052
Peru	2004	0.5350	0.0470	0.5344	0.0007
Uruguay	2006	0.4995	0.3635	0.4875	0.0120
Venezuela (Bolivarian Republic of)	2004	0.4230	0.4170	0.4210	0.0020

Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of A. Barreix, Bés and J. Roca, "Equidad fiscal en Centroamérica, Panamá y República Dominicana", Inter-American Development Bank (IDB)/EUROsociAL, 2009; A. Barreix, J. Roca and L. Villela, "La equidad fiscal en los países andinos", Inter-American Development Bank (IDB)/EUROsociAL, 2006; J.C. Gómez Sabaíni, M. Harriague and D. Rossignolo, "La situación fiscal y sus efectos en la distribución del ingreso", Washington, D.C., Inter-American Development Bank, unpublished, 2011; F. Rezende and J. Afonso, "Equidade fiscal no Brasil", *Equidad fiscal en Brasil, Chile, Paraguay y Uruguay*, Inter-American Development Bank (IDB)/EUROsociAL, 2010; and M. Jorrat, "Equidad fiscal en Chile. Un análisis de la incidencia distributiva de los impuestos y el gasto social", *Equidad Fiscal en Brasil, Chile, Paraguay y Uruguay*, Inter-American Development Bank (IDB)/EUROsociAL, 2010.

With specific regard to the impact of tax systems on income distribution, a study by Cubero and Vladkova Hollar (2010) confirmed the above-mentioned differences, with greater progressivity and a larger redistributive impact of taxation found in European countries (as compared with Latin American and Caribbean countries). Wang and Caminada (2011) use a mixed sample of 36 countries to show that Latin American countries have the highest levels of inequality and the lowest capacity for redistribution through taxation.

[1] Most recent studies find that, in all of the region's countries, the highest earning 20% of the population contributes over 90% of actual income tax receipts.

Lustig and others (2012) apply a standard incidence analysis to estimate the impact of direct taxes, indirect taxes, subsidies and social spending (transfers in cash and in kind for education and health needs) on inequality and poverty. The authors' main finding was that the reduction in inequality (measured by the Gini coefficient) attributable to direct taxes and transfers was extremely limited (2% on average), particularly compared with Western Europe (15% on average). This is due partly to a lower relative level of cash transfers (particularly the more progressive ones), but also to the smaller impact of direct taxes on inequality —as the amounts collected are about half that collected for indirect taxes in GDP terms. In most of the region's countries, indirect taxes have a regressive effect on income distribution.

Many tax incentives have also introduced various degrees of horizontal inequality in the region. According to Jiménez and Podestá (2009b), the tax incentives used by the region's countries include: (i) tax holidays and lower tax rates; (ii) investment incentives (accelerated depreciation, partial deduction, fiscal credits and tax deferral); (iii) special zones (free trade areas) with special tax status (relative to import duties, income tax or VAT); and (iv) employment incentives (tax breaks for labour hiring).

Table II.15 shows official estimates of tax expenditure disaggregated by type of tax. The uneven composition of taxes in the region's countries notwithstanding, most tax spending comes from the two main tax instruments: VAT and income tax. Tax expenditure also varies widely in relation to each country's tax burden: in Argentina, Brazil and Peru, tax spending represents a relatively small share of the tax burden, at around 10%; Chile and Colombia are in an intermediate position with around 20%; and in Ecuador and Mexico tax spending is over 30% of tax pressure. Methodological discrepancies make it difficult to compare countries, and this is particularly relevant to the high tax expenditure found in Guatemala.[2]

Table II.15

LATIN AMERICA (8 COUNTRIES): TAX EXPENDITURE BY TYPE OF TAX, 2007

(Percentages of GDP)

Tax	Argentina	Brazil	Chile	Colombia	Ecuador	Guatemala	Mexico	Peru
VAT	1.14	0.36	0.76	1.92	3.40	1.96	2.15	1.44
Income	0.51	1.11	4.21	1.60	1.20	5.28	3.02	0.29
Natural persons	-	0.66	3.31	0.24	0.80	4.35	1.56	0.19
Natural persons	-	0.45	0.90	1.36	0.40	0.93	1.45	0.10
Social security	0.25	0.74	-	-	-	-	-	-
Excise	0.13	0.00	-	-	-	-	-	-
Foreign trade	0.16	0.08	-	-	-	0.20	-	-
Other	0.02	0.00	-	-	-	0.46	0.76	0.32
Total *(percentages of GDP)*	2.21	2.29	4.97	3.52	4.60	7.91	5.92	2.05
Total *(percentages of tax collection)*	7.59	6.76	24.41	19.08	35.85	57.01	53.21	11.97

Source: J.P. Jiménez and A. Podestá, "Inversión, incentivos fiscales y gastos tributarios en América Latina", *Macroeconomía del Desarrollo series,* No. 77 (LC/L.3004-P), Santiago, Chile, Economic Commission for Latin America and the Caribbean (ECLAC), 2009.

[2] The high rate of tax expenditure in Guatemala is attributable to the treatment of the tax allowance threshold for income tax as tax spending (which is an exception to the generally accepted methodological rule), with a sharp fall estimated for 2005 (due to methodological changes rather than a withdrawal of benefits). In 2007, tax expenditure in Chile was more than double that of Argentina. Unlike Argentina, however, Chile's estimate includes an estimate of deferrals resulting from the marginal rate paid on income tax by companies and the maximum marginal rate on dividends distributed to individuals. Excluding this item would bring down total tax expenditure in Chile to 1.64% for 2007, below the figure for Argentina.

Although justified in some specific cases, tax expenditure has a negative impact on equity and efficiency. Foregoing a sum of tax revenues limits the fiscal space. Furthermore, granting benefits to a set group of taxpayers or activities generates a loss of horizontal equity. In terms of efficiency, tax expenditure has created problems of inter-jurisdictional tax competence and other distortions in industrial production and location decisions. The absence of studies and precise estimates on the real effects of tax expenditure on investment and economic activity casts doubt over their usefulness and effectiveness to achieve these objectives (while also reinforcing the above-mentioned disadvantages).

Tax spending also provides greater opportunities for manipulation of the tax system and may encourage tax evasion and avoidance. There are four reasons for this: (i) increased uncertainty regarding correct interpretation of the rules; (ii) reduced oversight capacity of the tax administration, because more complex rules require more rigorous audits; (iii) tendency of taxpayers not to comply with some of their tax obligations in more complex systems, either through lack of awareness or to offset the costs imposed by the system; and (iv) heightened complexity of tax rules and greater potential for evasion and avoidance created by tax spending (Villela, Lemgruber and Jorratt, 2009).

C. Towards a new fiscal covenant through stronger reciprocity

Implementing a fiscal covenant or social contract for a new, sustainable fiscal policy requires increased reciprocity as part of more inclusive and egalitarian relations. In the presence of exclusionary, unnecessary or asymmetrical reciprocity as in Latin America and the Caribbean, however, proposals are needed to offset incomplete or perverse reciprocity and facilitate a more balanced and long-term reciprocity relationship between the general population and the State. In particular, each of these incomplete or perverse forms of reciprocity can be tackled using a series of strategic proposals to gradually create a more inclusive and egalitarian reciprocity.

(1) A fiscal covenant with more reciprocity based on policies promoting employment formalization

Given the large swathes of informal workers —representing a situation of exclusionary reciprocity— there are two possible options for forging a closer State-citizen nexus and, more specifically, for bringing as many workers as possible into the formal sector and making them parties to the obligations and rights attached to that status. Existing proposals or reforms in the region suggest that the first option is to promote tax reform (particularly of direct taxation) that does not penalize formal employment. Examples include the income tax reform in Colombia, which eliminated items that increased during phases of rising job creation (contributions to the National Apprenticeship Service, the Colombian Family Welfare Institute (ICBF) and the System of Social Security in Health), and similar initiatives in El Salvador and Guatemala. Under these systems, wage expenditures were admitted as tax deductible items only for workers registered with social security.

The second strategic option is to strengthen the universal coverage of public spending using a rights-based approach. A universal social security system that encourages rather than penalizes formal employment, as well as universal health services, would certainly help to forge a closer link between citizens and the State. This proposal has already received considerable attention in Mexico (Anton, Hernández and Levy, 2012). Admittedly, providing basic universal coverage does require more resources for health and social security in particular, especially when the non-contributive pillar is strengthened.

(2) A fiscal covenant with more reciprocity through stronger institutions

Two additional strategic options may be considered for tackling the unnecessary reciprocity that may arise when a central or subnational government receives a high proportion of its resources from non-tax sources.

The first route towards dismantling the potentially unnecessary reciprocity resulting from perverse incentives —created by revenues from the exploitation of non-renewable natural resources— is to build robust, transparent and sustainable fiscal institutions. This could take the form of various specific macroeconomic actions or policies, based on the pioneering experience of some countries of the Organization for Economic Cooperation and Development (OECD), especially those with a high proportion of income from mining resources. Such actions and policies include: (i) structural fiscal balance rules to prevent procyclical fiscal policy (which occurs when rules establish a fiscal balance that is unchangeable from year to year); (ii) medium-term fiscal frameworks; (iii) sovereign wealth funds to invest savings accrued during boom times with a long-term perspective and countercyclical fiscal capacity; (iv) outsourcing of income projections in order to have credible and independent estimates; and (v) creation or strengthening of autonomous or parliamentary committees to assess and monitor fiscal policy. This can be considered as part of a transparency drive (which many countries are already promoting through freedom of information laws) and improvements to public spending quality and accountability.

The second strategic option would be to continue strengthening tax institutions, as demonstrated by the significant progress made by tax administrations in many of the region's countries. This would have to be part of making taxation a more robust basis for current expenditure, to ensure that subnational governments have their own collection capacity, with caps on over-borrowing. This would boost government-citizen reciprocity at the local level, which could be further developed through participatory subnational budgets, and would also strengthen subnational fiscal institutions.

(3) A fiscal covenant with more reciprocity based on equality

Lastly, where asymmetrical reciprocity is the result of such factors as veto powers, minority dictatorship or captured States, it is vital to work towards equality. There are three strategic options for a fiscal policy agreement.

The first strategic direction is to enforce equality under the law, in particular by strenuously tackling the challenge of applying the rule of law to the fiscal sphere. True fiscal justice implies

effective sanctions against evaders, including the largest ones, as well as punishment for spending-side corruption. This requires boosting the judiciary's capacity to implement fiscal policy. A social fiscal covenant or contract should therefore include agreements not only between the executive and the legislature, but also with the judicial power.

The second strategic direction is to boost horizontal equity. Surveys of Latin American taxpayers identify the lack of horizontal equity as one of the main sources of discontent and unwillingness to pay taxes. This route involves not only strengthening tax administration but also doing away with tax concessions, including subsidies, and closing fiscal loopholes and special regimes that harm the tax systems of developing/emerging countries and developed nations alike. Since such changes tend to elicit resistance from powerful groups, this type of commitment must be explicitly and transparently included in a broad political agreement such as a fiscal covenant.

The third course of action would be to promote vertical equity. As noted earlier, taxation in the region does not yet have a decisive and positive impact on inequality, despite recent progress in increasing income tax and collecting revenues from natural resource exploitation. In countries as unequal as those of Latin America, public spending alone cannot be relied upon to reduce inequality, but taxation must also play its part. Furthermore, it is essential to increase income tax not only to promote equality but also as an automatic stabilizer of business cycles.[3]

A new fiscal covenant touches upon vested interests, particularly those of certain elite groups who prefer to limit the coverage of public goods. These groups are likely to oppose tax reform initiatives aimed at funding more or better public goods for the majority of citizens. The fact that political freedom indicators have been found to be positively correlated with the proportion of direct taxation (Dioda, 2012) suggests that the limited expression of majority interests breeds asymmetrical reciprocity, and that these groups could have a greater negative impact on direct taxation in particular. Other differences may also be expected to arise in any reform process. Accordingly, a social contract on fiscal policy requires a long-term political vision that is shared by the majority. It must be constructed and implemented gradually through ongoing negotiations —but without losing its strategic and inclusive direction— thereby ensuring broad, continuous and equality-based reciprocity between citizens and the State.

[3] Encouraging the formalization of economic activity, spurred on by tax reforms or non-contributory universal social security systems, would expand the effective tax base for income tax.

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