Wilson
Center
LATIN AMERICAN PROGRAM

I. Introduction

Latin American taxation has been one of the enduring and continuing interests in my professional life, an interest that has stretched over a period of half a century. My first published papers on that topic were in the mid 1960s. My most recent ones were published in recent years. I also coedited a book on that topic for the IDB, that was published in 2008, and contributed to another recent book on the same topic. See Bernardi et al. editors, 2008. In addition to this more academic work, I published two popular books, in 2007 and 2010, on Latin American countries. These books contain several references to taxes in several Latin American countries.

Over the last five decades I participated in many tax conferences and tax missions to countries that ranged from large countries, such as Argentina, Brazil, and Mexico, to smaller countries, such as Costa Rica, Haiti, and Jamaica. Because of these activities, I feel that I can claim more than a passing interest, or knowledge, of Latin American taxation.

In my talk today, I shall focus my remarks on two main questions:

First, have there been significant changes, and in the right direction, in the tax systems of the Latin American countries, in recent decades? Second, what has happened to the taxation of income, and especially of personal income?

II. Changes in the Tax Systems

The changes that take place in the tax systems of countries may be significant for *tax levels*, as shares of GDPs, or for the *structure* of the tax systems.

The "Declaration of Punta del Este" that, half a century ago, created the *Alliance for Progress*, mentioned, as one of the important goals to be promoted by that *Alliance*:

"To reform tax laws, demanding more from those who have most…" More specifically, the Declaration stated that it would be necessary to promote: "…the reform of tax structures, including fair and adequate taxation of incomes…"

The *Alliance for Progress* established, in Washington, an office called the "*Joint Tax Program*" that was charged with the task of promoting tax reforms in the Latin American countries. The *Joint Tax Program,* that was financed jointly by the UN, the IDB, and the Organization of American States, became, for more than a decade, the main actor in reforming tax systems in Latin America. It relied on leading tax experts, from Latin America, the United States, and occasionally from Europe, to do its work. Its guiding principles were:

(a) To raise tax levels and to make the tax systems more progressive;

(b) To advice Latin American governments to keep current government expenditure low, in order to generate *budget surpluses* in the current account;

(c) To use the budget surpluses to finance capital spending by the government, in order to create infrastructures that, it was felt, were essential to make the countries' economies grow;

(d) To promote *private* investment through the use of tax incentives.

Thus, (a) the level of taxation, (b) the revenue from income taxation, and (c) the tax incentives were the main variables to influence, in desirable directions, through the tax reforms. It should be recalled that this was the time when "Harrod and Domar growth models" or the "Solow growth model" were very popular. These models gave prominence to investment (both public and private), as the promoter of growth. They assumed that, countries that invested a larger share of their GDP grew more rapidly than those that invested less, ceteris paribus. The government was seen to have an obligation to promote growth, by promoting both public and private investment.

The needed increase in the tax levels was expected to come mainly "…from those who have most…" because of the highly uneven income distribution that prevailed in Latin American countries. That distribution concentrated much of the potentially taxable capacity in the higher

As the authors of that paper put it:

“[The] tax burden has increased considerably…” However, they add, “…while some countries, such as Brazil and Argentina, currently have tax burdens exceeding 30% of GDP, others, such as Ecuador, Guatemala, and Paraguay, have tax burdens of no more than 14% of GDP.” Ibid. p. 11. Because of the latter countries’ lower tax burdens, they seem a bit

Fourth, some of the countries with lower tax burdens (Mexico, Chile, Peru, Bolivia and some others) have significant revenue from rents collected from the governments' ownership of natural resources. Because of these rents, they can finance higher spending than indicated by their tax revenues.

Finally, we should never forget that a higher tax burden is not always preferable to a lower tax burden. Whether it is or it is not, depends on the governments' capacity to use well, *in economically productive and socially desirable ways*, the extra tax revenue generated by the higher tax burden. When the additional revenue is wasted in projects with low economic productivity, or in expenditures with low social justification, one should not praise the governments for the extra fiscal efforts. In these circumstances it would have been better to leave the money in the hands of the taxpayers; even more so when the tax systems are not progressive. For elaborations of this argument, see Tanzi, 2008a.

In any case, the comparisons between LAC and OECD countries, as shown in OECD 2011, p. 17, or in Gomez Sabaini and Jimenez, 2011, p. 22, are less revealing than they seem to be. They tell little about the taxation of the *majority* of the *population* (as compared with the *majority* of *countries* of widely different sizes). We should not give the same weight to Brazil and, say, Honduras. It is now highly likely that a larger share of the population (and not of the countries) of Latin Am

a wrong impression. As with icebergs, the changes may often take place below the visible part and, thus, may not be immediately noticeable.

It can be maintained that the changes that took place over the years have made the Latin American tax systems far better than they had been in the past. The reason is that, in terms of allocation of resources, and in terms of providing the countries' governments with better tax instruments for pursuing stabilization policy, through their ability to introduce more easily revenue changes when needed, the reforms in the tax structures made over the years significantly improved the tax systems of many Latin American countries.

In recent decades, remarkable and broadly positive changes took place, especially in indirect taxes. The very high excise taxes on "luxury or non essential products", that had existed in the past and that, except for justifications connected with possible, negative externalities in the use of some of the taxed commodities, had been highly distorting in the allocation of resources, have generally become less important. Import duties (used as highly distorting protective devises for domestic industrial activities) have been largely replaced by, much more allocation-neutral, value added taxes and by lower import duties. Especially the introduction of widely -based value added taxes has represented a tectonic change. It has been far more successful than anyone would have expected three decades ago. See OECD, 2011, Table B, p. 19 for the VAT's revenue data. Let me provide a concrete example of this change.

In 1990, Argentina was collecting less than two percent of GDP from the VAT. When the members of a technical assistance mission to Argentina from the IMF proposed some changes in the Argentine VAT, and estimated that the reformed VAT might raise the VAT revenue from two to six percent of GDP, incredulous Argentine experts derided them! Such an increase was simply not considered a realistic possibility in a country with the tax administration and the tax evasion that Argentina had at that time. See Tanzi 2007. By 2009, Argentina was collecting close to 11 percent of GDP from this tax, and OECD statistics estimate that in Brazil the revenue from this

were no tax evasion. But of course, because of the tax evasion, some taxpayers gain or lose more than some other taxpayers while the whole country loses because it ends up with an inferior tax system. Therefore, tax evasion is always a problem of equity, but not always one of revenue losses.

III. On the Revenue Contribution of Income Taxation

Up to the 1980s, the taxation of incomes had changed relatively little in Latin America. High inflation had often had a major, negative, impact on income tax revenue. See Tanzi, 1977. The statistics now available indicate that, in the first decade of the new millennium, when inflation was no longer a problem, there were significant increases, in some countries, in the revenue from income taxes. However, much of the additional revenue came from income taxes on

who receive them. Therefore, they should be taxed in the same way, and possibly with progressive rates, on their aggregated, or "global", total.

In recent decades, starting in the 1970s, the Haig –Simon concept started being attacked, and, over the years, the *architecture of the income tax*

Concluding Remarks

It has been a pleasure for me to speak at this conference on issues that have fascinated me for half century. There is little doubt in my mind that, over the 50 years, during which I have been interested in Latin America, the Latin American countries have made a lot of progress on their tax policies. However, when I assess the reply to the questions posed in the yearly surveys conducted by **Latinobarometro,** I am not sure that the progress on the spending side has been equally good in spite of some recent worthwhile programs. Let us not lose sight of the fact that taxes should always be collected as equitably as possible, but also that *higher* taxes are more justified when the additional revenue collected are well spent by the governments that collect them. There are some doubts whether this is the case. See Tanzi, 2008.

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