C61

CHAPTER

61

Taxation and State Capacity

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Abstract

Although Latin American tax systems have historically reflected a lack of state capacity, reforms of taxation and administration in the past few decades have strengthened states in several ways. Governments in the region still do not tax as progressively as most others in the world, but the "neoliberal" tax and administrative reforms, enacted with the help of international financial institutions from 1967 to about 2000, did raise revenue more effectively. They also laid the groundwork for greater confidence in the impartiality of tax enforcement and the control of spending. In addition, many of the same technological advances that have facilitated the evasion of taxes on capital assets and income have also aided tax innovations that enhance both equity and efficiency. Independently of these trends, the commodity boom of the 2000s helped fund an expansion of social spending. And along with a few mildly progressive tax reforms, this has brought Latin American patterns closer to the expectations of two major theories of fiscal politics, the median voter model and the idea of the fiscal contract.

Key Words: Latin America, tax system, state capacity, tax reform, progressive taxation, tax enforcement, tax evasion

C61.P1 Citizens of developed countries, even widely read political observers, too often take the existence of a competent state administration for granted. They seem to imply that the tools of government are sharp and ready to hand, so that we need only decide the common tasks on which to use them. Citizens of Latin America are much less likely to make this mistake. They recognize that when it comes to government, state capacity is the heart of the matter. Without it, crime surges, the economy stagnates, and democracy breaks its promises. And of course, state capacity depends on revenue.[1]

[1] Highly respected scholars have argued that measuring state capacity by tax revenue conflates capacity with policy preferences, so that we ought to distinguish between actual and potential revenue (Soifer 2013, 9). The federal government in the USA, by this argument, currently taxes much less than it proved it could do during World War II (Fukuyama 2013). One problem with this scenario is that it ignores how difficult it would be to raise taxes without what taxpayers regard as a good reason. Rogers and Weller (2014) argue that revenue from income taxation, rather than total rax revenue is a better measure. See also Soifer and Vom Hau (2008) and Ottervik (2013) on taxation and state capacity.

C61.P2 Yet although it is perhaps a necessary condition, revenue is surely not sufficient for a capable state. Administration matters. Nor does abundant revenue necessarily imply strong tax administration. Money could flow easily from a few oil wells. Trade taxes, the historic foundation of many early modern states, require only a small cadre of trained officials in a few ports. A handful of excises might produce steady revenues without discomfiting anyone with political power. It is also possible that a highly competent tax authority could serve a state that is otherwise corrupt and disorganized, in which funds were wasted in graft, showered upon politically favored groups, or directed almost entirely to a small portion of the national territory. In fact, all of these possibilities, to varying degrees, have been present in Latin America.

C61.P3 However, despite varied experiences across the region, it is fair to say that overall, states in Latin America have increased their revenues substantially over the past three decades while becoming more regularized in their tax administration and transparent in their spending. The revenues—buoyed up for many years by a commodity boom—have permitted a greater commitment to the alleviation of poverty, much of this by means of new quasi-universalistic programs. Notably, in their reforms of taxation, administration, and social welfare, Latin American governments have responded to the influence of international financial institutions, regional associations of administrative professionals, and each other. These developments, in turn, ought to affect how we think about how Latin America fits into theories of fiscal politics, such as the median-voter model (which predicts more redistribution than we have seen) or the fiscal-contract perspective (which predicts political activation as taxes rise).

C61.P4 This review seeks to contextualize, historically and theoretically, the relationship between taxation and state capacity in Latin America. The region's governments have always relied to an unusual degree on regressive consumption taxes, given administrative weakness and the political dominance of landed oligarchies. Recent reforms and new technologies have begun to change this, mostly by raising more revenue and by making states capable of fairer tax enforcement and more equitable and transparent spending, including new programs for poverty alleviation. Together with progressive tax reforms in a few countries, these bring the politics of fiscal policy in the region closer to what major theories of political economy would predict.

C61.S1 The Latin American Pattern: Elite Dominance and Consumption Taxes

C61.P5 Latin American governments have traditionally funded themselves mainly from consumption taxes. In Spanish America, post-Independence attempts to impose a property tax (inspired by European liberalism) failed, largely because of landowner resistance (Burgin 1946; Adelman 1999; Pinto 2012). As a result, a minimal level of state consolidation, when it was finally achieved, depended almost entirely on an indirect and regressive tax, the import tariff. In fact, for most of the so-called liberal period after about 1860, Latin America had the highest average tariff rates in the world, mostly because tariffs were the

easiest and, to the landowning elite, the most politically acceptable tax (Márquez 2005; Coatsworth and Williamson 2004). Still, some governments managed to achieve greater success at taxing real property by about 1900, above all in cities (Santilli 2010; Herrera and Ferraro 2013; Soifer 2015). And national governments in Chile and Uruguay did impose significant (direct) taxation of property and inheritances relatively early on, while their states became more capable (Soifer 2015; Finch 1981; Bulmer-Thomas 1994; Kurtz 2013). Nevertheless, until well into the 20th century, even in Chile and Uruguay the most important revenue sources were in fact the regressive ones—import tariffs, excises on staple goods, and inflation.

C61.P6 In the 20th century, even as development strategies changed markedly, the overall structure of taxation remained relatively stable. It is true that by interrupting or diminishing the value of trade, the wars and slumps of 1914–45 prompted most of the larger Latin American countries to experiment with income taxes to replace the lost revenue from tariffs. But these taxes hit urban commercial and financial interests more heavily than elites in the countryside, and they raised relatively little revenue. After World War II, with import-substituting industrialization the pole star for policy, especially in the larger countries, the weakness of many governments' tax systems showed up in chronic inflation. In the early 1960s the US Alliance for Progress sought to fortify income taxes on individuals and companies (Sommerfeld 1966), but these efforts generally failed, leaving systems that were complicated, inefficient, and unprogressive (Best 1976; Bird 1992; Zolt and Bird 2005). States remained weak. Indirect taxation, mainly on trade and selected goods, remained the most important pillar of the fiscal edifice.

C61.P7 The major reforms after 1965 did not change the reliance on consumption taxes. While every country in Latin America increased its tax take significantly, the most important substantive change was the switch from trade taxes to new consumption taxes. From 1967 to the late 1990s, "neoliberal" reforms simplified tax codes, reduced rate progressivity, strengthened tax administration, cut trade duties and, most notably, instituted or expanded the value-added tax (VAT) (Bird 1992; Shome 1995; Mahon 2004; Thirsk 1997; Keen and Simone 2004). Then, over the next decade and a half, governments adjusted these systems, sometimes adding heterodox taxes on financial transactions, while generally taking in additional revenue relative to GDP (Focanti et al. 2013).

C61.P8 Since 2005 a few countries have seen reforms that marked a halting turn in a more progressive direction on the tax side. Most notably, in Uruguay (2005–6) and Chile (2014), reformers placed new emphasis on income taxes while seeking to expand revenue for broadly redistributive goals (Rius 2015; Fairfield 2015a). However, the revenue impact of these reforms has been modest: in Uruguay, for example, the personal income tax brought in about 15 percent of all revenues in 2016,[2] while studies of tax return data in

[2] Dirección General Impositiva, at http://www.dgi.gub.uy/wdgi/page?2,principal,dgi--datos-y-series-estadisticas--serie-de-datos--recaudacion-anual-y-mensual-por-impuesto,O,es,0,

Chile show that households in the top thousandth still pay relatively little (Fairfield and Jorratt 2015).[3]

C61.P9 In sum, although tax revenues have risen nearly everywhere across Latin America in recent decades (as we will see in more detail to come), after two generations of reforms the region's distinctive tax profile remains. It combines an unusually great reliance on indirect taxes and, from the personal income tax, a proportional contribution to total revenues that is smaller, on average, than in other regions of the world (Table 61.1). Compared to other regions, also, the contribution of taxes on real estate is remarkably small—a legacy, perhaps, of rural elite dominance post-Independence (Corbacho et al. 2013). Thus, the taxes that are most likely to be progressive in their incidence are also the least prominent in the Latin American fiscal structure.

C61.S2 New State Capacity?

C61.P10 What does this say about state capacity? If we judge by the ability to tax the income or assets of the richest households significantly, the region's governments look weak. However, for many analysts, the simple tax revenue/GDP ratio is a useful indicator (see discussion in Fukuyama 2013)—and by this measure, recent reforms will have enhanced it. We have also seen important administrative and technological advances, especially in the last 20 years. Interestingly, on both of these fronts, external actors have played prominent roles.

C61.S3 *Tax Revenue and GDP*

C61.P11 Reforms over the past generation have significantly increased the tax take of governments across the region. Table 61.2 shows central government tax revenues since 1990 for Latin America along with the regional and OECD averages. The (non-weighted) average of the 16 Latin American countries listed rises from 10.2 percent in 1990 to 14.9 in 2016 (an increase of 46 percent), much more than does the OECD average. We see a similar story in Table 61.3, which shows general government revenue, the regional average of which rises from 13.6 to 20.7 percent of GDP (a 52 percent increase).

C61.P12 However, the averages conceal diverse paths. Argentina, Ecuador, and Paraguay rose much more than the average, while Brazil's tax take fell sharply after 2007, leaving the government at revenue levels about equal to those of 1999. Meanwhile, Mexico's revenue figures remained stuck in the range of 9–11 percent of GDP before increasing in 2015–16, while Costa Rica, Guatemala, and Panama remained more or less stable over most of the period. Data for Venezuela show a pronounced rise in 2014–15, but this is probably due to the shrinkage of the denominator.

C61.P13 How much of this pattern can be explained by the pronounced rise in commodity prices, beginning in 2003? Tax revenues in Argentina, Ecuador, and Paraguay surely

[3] The countries most identified with the "new left" (Venezuela, Bolivia, Ecuador) funded new social programs mainly from resource rents rather than taxation of consumption or income.

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Table 61.1 Regional averages of relative weights of personal income, corporate income, import tariffs, and consumption taxation in total central government revenues, percent, 2000–10 (Columns 1–7); tax revenues as a percentage of GDP (Column 8). Number of observations in parentheses.

Region or Group	(1) Personal Income Tax	(2) Corp Income Tax	(3) Taxes on Imports	(4) Domestic Taxes on Consumptn	(5) Sum of (3) and (4)	(6) Ratio (4)/(1)	(7) Ratio (5)/(1)	(8) *Tax Rev/ GDP*
OECD Europe, ex-UK	22.63 (19)	11.47 (19)	0.28 (18)	41.47 (19)	41.75	1.83 (19)	1.84	*20.83 (19)*
UK and former British settler colonies	40.11 (5)	13.72 (5)	1.39 (5)	21.08 (5)	22.47	0.53 (5)	0.56	*21.16 (5)*
Latin America	4.41 (13)	12.36 (12)	6.91 (13)	45.66 (18)	52.57	10.36 (13)*	11.92	*11.73 (18)*
Sub-Saharan Africa	12.03 (34)	9.51 (33)	18.54 (27)	30.42 (38)	48.96	2.53 (34)	4.07	*13.35 (40)*
Eastern Europe and Eurasian ex-Communist	8.07 (23)	10.05 (24)	4.30 (21)	52.09 (24)	56.39	6.45 (23)	6.99	*15.31 (26)*
South and East Asia	10.05 (18)	15.35 (17)	12.39 (17)	30.51 (18)	42.9	3.04 (18)	4.27	*12.15 (21)*
Middle East and North Africa	6.08 (11)	9.07 (9)	6.93 (9)	17.73 (15)	24.66	2.92 (11)	4.06	*10.16 (17)*

* Average consumption tax percentage of total revenue divided by average personal income tax percentage of revenue for the 13 countries with data for both: Bol, Bra, Chi, Col, CR, DR, Gua, Hon, Mex, Pan, Par, Per, Uru.

Source: International Centre for Tax and Development (ICTD) database, available at http://www.ictd.ac/en/about-ictd-government-revenue-dataset

C61.T2

Table 61.2 Tax revenue as a percentage of GDP, Central Government, 1990, 1995, and 2000–2016, plus Latin America and OECD averages

Tax Rev/ GDP, central govt	1990	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Argentina	8.1	11.0	13.1	13.0	12.7	15.5	17.8	17.8	17.8	18.5	19.1	18.5	18.8	18.7	19.2	18.9	19.1	19.5	19.2
Bolivia	8.3	13.1	15.2	14.4	14.6	14.1	16.3	17.8	17.2	17.8	19.2	19.5	18.1	19.6	20.1	20.9	21.4	22.1	20.4
Brazil	11.2	11.9	14.1	14.8	15.3	15.0	15.5	16.1	17.1	17.6	15.9	14.4	14.7	15.4	14.5	14.5	13.9	14.0	14.1
Chile	15.0	16.5	16.5	16.7	16.7	16.4	16.8	18.4	19.9	20.6	19.0	14.8	17.2	18.7	18.8	17.3	17.0	17.8	17.6
Colombia	7.8	9.5	10.0	11.6	11.7	12.2	12.6	13.1	14.0	14.1	14.1	13.6	13.0	14.2	15.0	14.7	14.6	14.9	13.9
Costa Rica	14.0	11.9	12.3	13.2	13.3	13.4	13.4	13.7	14.0	15.2	15.6	13.7	13.4	13.6	13.6	14.0	13.8	14.3	14.3
Dom Rep	7.7	9.9	10.7	12.1	12.2	10.7	10.2	11.9	13.5	14.9	14.2	12.7	12.2	12.3	13.0	13.7	13.8	13.5	13.6
Ecuador	5.5	5.7	8.9	9.7	9.6	8.6	8.7	9.0	9.1	9.3	10.6	11.6	12.6	12.3	13.9	14.4	14.1	15.6	15.0
Guatemala	7.4	8.7	10.4	10.7	11.7	11.4	11.3	11.0	11.6	11.8	10.9	10.2	10.3	10.7	10.7	10.8	10.7	10.2	10.3
Mexico	9.9	8.4	10.4	11.0	11.1	10.7	9.6	9.3	9.6	9.9	10.6	10.2	10.6	10.5	10.2	10.7	11.1	13.0	14.0
Nicaragua	..	9.2	10.4	9.7	10.4	11.7	12.1	12.9	13.6	13.8	13.2	13.1	13.6	14.5	15.0	15.0	15.3	15.6	16.2
Panama	11.0	11.4	9.5	8.5	8.5	8.5	8.3	8.4	10.0	10.2	10.2	10.3	10.7	10.3	11.1	10.8	9.8	9.8	10.2
Paraguay	5.8	12.1	10.4	10.0	9.0	9.6	11.2	11.2	11.4	11.2	11.7	12.9	13.2	13.8	14.3	13.1	14.3	13.7	13.5
Peru	11.2	13.9	12.8	14.6	12.6	13.4	13.6	14.3	15.8	16.3	16.3	14.4	15.4	16.2	16.7	16.5	16.4	14.6	13.5
Uruguay	12.5	12.9	13.4	13.9	14.0	15.2	16.5	17.0	18.1	18.2	19.1	18.4	18.7	18.8	18.6	18.9	18.4	18.4	17.7
Venezuela	17.2	12.1	12.9	11.4	10.6	11.3	12.7	15.3	15.6	16.1	13.5	13.3	10.9	12.5	13.2	13.5	17.9	20.2	14.2
LAm 16 country average	**10.2**	**11.1**	**11.9**	**12.2**	**12.1**	**12.4**	**12.9**	**13.6**	**14.3**	**14.7**	**14.6**	**13.8**	**14.0**	**14.5**	**14.9**	**14.8**	**15.1**	**15.4**	**14.9**
OECD average	**19.4**	**20.3**	**21.3**	**20.7**	**20.5**	**20.4**	**20.4**	**20.8**	**20.9**	**21.0**	**20.2**	**19.2**	**19.5**	**19.7**	**19.9**	**20.1**	**20.4**	**20.3**	**..**

Source: OECD.Stat (https://stats.oecd.org/)

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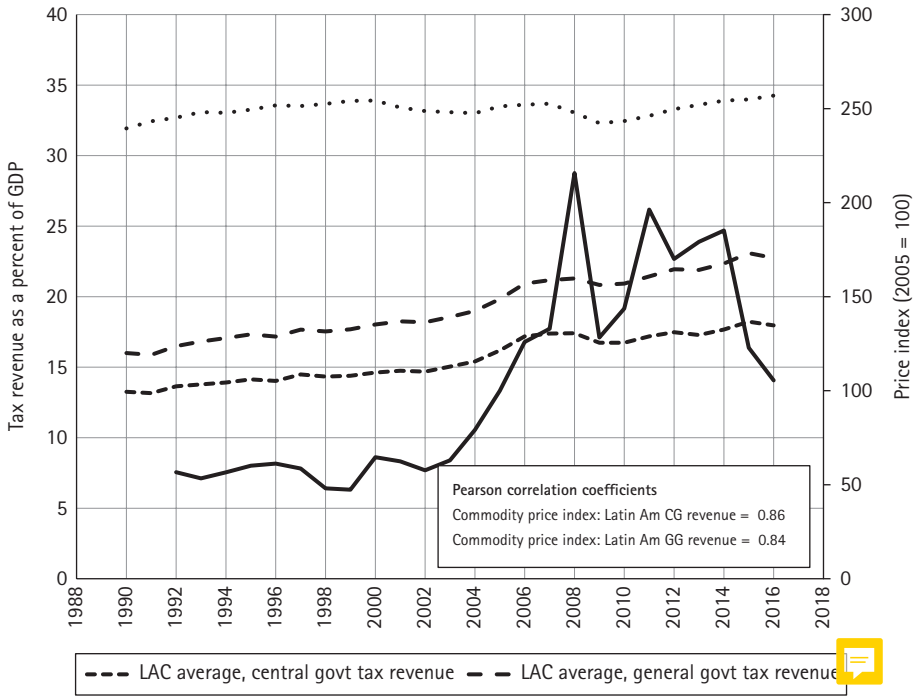
Table 61.3 Tax Revenue as a percentage of GDP, General Government, 1990, 1995, and 2000–2016, plus Latin America and OECD averages

Tax Rev/ GDP, general govt	1990	1995	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Argentina	13.7	18.7	19.8	19.3	18.4	21.6	24.3	24.5	25.1	26.4	27.6	28.9	29.1	29.3	30.6	31.2	31.1	32.0	31.3
Bolivia	8.3	13.8	17.6	16.6	16.9	16.4	18.7	20.0	19.3	19.8	21.2	21.7	20.3	22.1	24.4	25.3	26.2	27.6	26.0
Brazil	25.5	26.6	29.6	30.7	31.4	30.9	31.8	32.8	34.8	35.1	33.7	32.1	32.4	33.2	32.5	32.4	31.8	32.0	32.2
Chile	16.9	18.3	18.8	19.0	19.1	18.8	19.1	20.7	22.0	22.7	21.4	17.3	19.6	21.1	21.3	19.9	19.6	20.5	20.4
Colombia	10.6	15.0	14.6	16.3	16.2	16.7	17.5	18.1	19.1	19.1	18.8	18.6	18.0	18.8	19.7	20.1	20.4	20.8	19.8
Costa Rica	21.3	17.4	18.4	19.4	19.7	19.7	19.6	20.0	20.5	21.9	22.5	21.0	20.7	21.2	21.2	21.9	21.9	22.6	22.2
Dominican Republic	7.8	10.0	10.8	12.2	12.4	10.8	10.2	11.9	13.6	15.0	14.2	12.7	12.3	12.3	13.1	13.7	13.8	13.5	13.7
Ecuador	7.3	8.1	10.3	11.8	12.7	11.8	11.8	12.1	12.7	13.2	14.3	15.2	16.6	17.7	19.8	19.6	19.2	21.1	20.5
Guatemala	8.8	10.4	12.4	12.7	13.7	13.5	13.4	13.1	13.8	13.9	12.9	12.2	12.4	12.8	12.9	13.0	12.7	12.4	12.6
Mexico	12.4	11.4	13.1	13.9	14.0	13.5	12.3	12.1	12.2	12.6	13.2	13.0	13.4	13.3	13.1	13.8	14.2	16.2	17.2
Nicaragua	..	10.9	13.0	12.6	13.3	14.7	15.3	16.1	17.1	17.4	16.8	17.1	19.4	20.3	20.9	21.2	21.8	22.3	22.6
Panama	15.9	18.4	15.9	14.8	14.4	14.1	13.9	13.8	15.2	15.7	16.0	15.8	16.7	16.5	16.8	17.1	15.7	15.9	16.6
Paraguay	5.8	12.1	12.6	11.9	10.8	11.6	13.1	13.8	14.2	13.9	14.6	16.1	16.5	16.9	17.7	16.4	17.8	17.9	17.5
Peru	12.1	15.8	14.6	16.8	14.8	15.5	15.7	16.4	17.9	18.4	18.8	16.9	17.8	18.6	19.3	19.2	19.0	17.2	16.1
Uruguay	19.6	21.0	21.6	22.0	21.1	21.5	22.7	23.9	25.1	25.1	26.1	25.9	26.2	26.6	26.9	27.5	27.3	27.0	27.9
Venezuela	18.1	12.8	13.6	12.2	11.2	11.9	13.3	15.9	16.3	17.0	14.2	14.2	11.8	13.4	14.1	14.4	18.9	20.8	14.4
LAm 16 country average	**13.6**	**15.0**	**16.0**	**16.4**	**16.3**	**16.4**	**17.0**	**17.8**	**18.7**	**19.2**	**19.1**	**18.7**	**18.9**	**19.6**	**20.3**	**20.4**	**20.7**	**21.2**	**20.7**
OECD average	**31.9**	**33.3**	**33.9**	**33.4**	**33.2**	**33.1**	**33.0**	**33.5**	**33.6**	**33.7**	**33.0**	**32.3**	**32.5**	**32.8**	**33.3**	**33.6**	**33.9**	**34.0**	**34.3**

Source: OECD.Stat (https://stats.oecd.org/)



C61.F1 **Figure 61.1.** Regional averages of tax revenue (OECD) and commodity prices (IMF), 1992-2016.
Sources: OECD.Stat and IMF (https://www.imf.org/en/Research/commodity-prices)

benefited (helped by new export taxes in Argentina after 2007 and import tariffs in Ecuador in 2015–16). Figure 61.1 plots the averages of central government and general government tax revenues for Latin America and the Caribbean (all 19 countries tracked by the OECD, rather than the 16 selected in Tables 61.2 and 61.3), general government revenues for the OECD, and an all-commodity price index. As we can see, the Latin American revenue lines noticeably reflect, though weakly, the ups and downs of the commodity price line—with the upward inflection point around 2003—while the OECD line does not. Correlation coefficients (in the box at lower right on Figure 61.1) bear this out: they are highly positive for Latin America and weakly negative for the OECD group. However, we should note the difference before and after 2003. For the 1992–2003 period, the commodity series correlates with the Latin American revenue series at only 0.35 and 0.36, rather than 0.86 and 0.84 for the entire interval.

C61.P14 This is a noteworthy result, to which we can add two further points. First, it probably understates the dependence of Latin American government revenue on commodity prices. This dependence involves both a first-order relationship in which revenues come directly from commodity production or exports, and a second-order one involving revenues from an economy connected in various ways to the production of commodities. For example, in Uruguay the second-order relationship likely dominates, and thus the revenue

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Table 61.4 Correlation Coefficients between all-commodity price index (IMF) and tax revenues, central or general government (OECD), or total central government revenues (UN-ECLAC), 1992–2015

	Pearson correlation coefficient, 1992–2015, between all-commodity price index and:		
	Central gov't tax rev	General gov't tax rev	Central gov't total rev
Argentina	0.841	0.856	0.849
Bolivia	0.836	0.775	0.890
Brazil	0.523	0.693	0.890*
Chile	0.535	0.628	0.595
Colombia	0.852	0.805	0.880
Costa Rica	0.759	0.841	0.851
Dom. Rep	0.772	0.766	0.899
Ecuador	0.738	0.776	0.877
El Salvador	0.832	0.817	0.885
Guatemala	0.407	0.448	0.768
Honduras	0.115	0.374	0.618
Mexico	0.246	0.224	0.744
Nicaragua	0.797	0.804	0.755
Panama	0.149	0.097	0.325
Paraguay	0.703	0.782	0.705
Peru	0.857	0.906	0.892
Uruguay	0.904	0.881	0.561
Venezuela	0.270	0.310	0.607
LAC average	0.856	0.845	
OECD average	-0.262	-0.084	

* General government (data series much more complete than for central government).
Sources: OECD.Stat (https://stats.oecd.org/); CEPALstat (https://statistics.cepal.org/portal/cepalstat/dashboard.html?lang=en)

in question enters mainly via the VAT and, to a lesser degree, income taxes. As we can see in Table 61.4, the correlation between commodity prices and Uruguayan tax revenues is much higher than the correlation with total revenues. In Mexico, the first-order relationship is very important, but it generates a flow—profits accruing to PEMEX—booked as property income, not taxes. Accordingly, Mexico's tax revenue correlates less strongly with the commodity index than does its total revenue in Table 61.4. Ecuador's, by contrast, creates a substantial flow via the corporation income tax (so its tax revenue correlation with the price index is high), even though the taxpayer is Petroecuador. Second, we

have to be careful what we assume about the taxation of commodity sectors in the first-order relationship. Some commodity taxes have to overcome powerful political opposition but require relatively little administrative effort. For example, President Fernández de Kirchner's imposition of export retentions in Argentina would be counted as a minor expansion of state administration while expressing considerable political power. Our assessment thus depends, to some degree, on how we define state capacity.

C61.P15 In any case, we should resist the temptation to conclude that because fiscal revenues rose during a commodity boom, they necessarily involved the increased reliance on politically or administratively "easy" sources. An expansion of revenues by the second-order channel would implicate modern tax instruments—the VAT and corporation income tax principally, excises on consumption secondarily—tapping a growing, commodity-linked economy. They would also be less volatile, being based principally on consumption rather than income. For example, in Table 61.4, Costa Rica's revenue correlation with commodity prices is nearly as high as Peru's and higher than Chile's, though as we can see in Tables 61.2 and 61.3, it is also much less variable.

C61.S4 *Administrative Reforms and Legitimacy*

C61.P16 In globalized Latin America, a rise in tax revenues as a proportion of GDP cannot be taken for granted. It requires continual administrative efforts to counteract what Tanzi has called "fiscal termites" (2000). Even more has this been the case after the capital flight of the 1980s put the assets of the wealthy out of the reach of the region's governments (Tanzi 2003). As a result, their drive to raise the proportional tax take from the remaining available base has involved not only administrative reforms but also related efforts at taxpayer persuasion.

C61.P17 Along with the VAT, administrative renovation of tax authorities has been the most common feature of the major tax reforms in Latin America since the 1960s.With the abolition of a host of minor taxes and stamp duties, tax offices once organized by type of tax now became centralized and, where necessary, organized by function (e.g., records, auditing, legal) and the size of the taxpayer's obligations. Computer files replaced piles of paper. In addition, as Keen and Simone observe, the adoption of the VAT itself made a difference, "in particular by introducing methods of self-assessment—that is, self-declaration of liability by the taxpayer supplemented by risk-based audits—that can then be applied to other taxes" (2004, 319). More recently, the turn toward electronic invoicing (now compulsory in Mexico and elsewhere) makes VAT fraud easier to detect (UN-ECLAC 2017; CIAT 2018). And efforts to streamline registration and make audits effective have in fact led to declining VAT evasion in Chile, a regional leader in tax administration (Chile, Ministerio de Hacienda 2018).

C61.P18 The most visible reform granted tax authorities statutory autonomy from the finance ministries in which they were once housed (Lora 2007). Labeled ARA's or SARA's

(autonomous or semi-autonomous revenue authorities) among tax professionals, these institutions symbolized a new adherence to bureaucratic norms. Indeed, this symbolism was perhaps the key feature: as a World Bank researcher argued, "politicians create ARAs in order to signal a credible commitment to taxpayers that tax administration will be more effective, fair, and competent" in order to increase tax compliance (Taliercio 2004, 213). Taliericio's (2004) survey data indicate that greater perceived autonomy correlates with perceptions of better performance, while autonomy also predicts actual efficiency, measured by expansion of taxpayer registrations and collection costs as a proportion of revenues. The bulk of these reforms were completed in the 1990s, during a period of gradual revenue growth before the commodity-fueled gains that began around 2003.

C61.P19 In Latin America as elsewhere, the most common reasons for taxpayer disgust are the perception that revenues are used poorly—corruption and poor public services—and the suspicion that others are evading their tax obligations. Construed most narrowly, state legitimacy is enhanced when administrative autonomy reassures taxpayers that audits are not politically motivated and hence more likely to detect real evasion. In addition, a tax authority that treats taxpayers as clients will facilitate registration and declaration, making it easier to stay within the law and comply. At the most general level, in the words of IDB researchers, "efforts to reassure taxpayers that their tax payments are being used to fund socially beneficial public goods and services" will improve the legitimacy of the tax regime, and hence compliance (Corbacho et al. 2013, 111; for evidence, see Torgler et al. 2010). And tax administrators in the region have been paying attention too: in 2011 the general assembly of the regional association of tax administrators, CIAT (Centro Interamericano de Administradores Tributarios), centered on the theme of taxpayer morale and agency effectiveness.[4]

C61.P20 One development is particularly emblematic. Since the early 2000s, and after 2008 with the coordination and support of EurosociAL (the EU program for social cohesion in Latin America), many tax authorities in the region have created programs of fiscal education (*cultura tributaria*). These typically include public service messages for television broadcast as well as modules suitable for elementary education, and they sometimes include dedicated radio broadcasts and secondary-education modules as well. Combining themes of good citizenship and cooperation with a focus on the good things funded by taxes, they seek to encourage compliance, in part, by nudging public attitudes away from cynicism about government spending.

C61.S5 ### *The Role of External Actors*

C61.P21 Fiscal education is a minor recent example of the way in which foreign actors have played a role in the past generation of reforms. Among the most prominent have been

[4] The program can be viewed at https://biblioteca.ciat.org/opac/?v=4896

CIAT and the multilateral financial institutions. The latter took on a key role around big reform "moments," whose precipitating event was often a hyperinflationary crisis. These crises and other fiscal shortfalls drove governments into the arms of the IMF, whose loans often bore tax reform as a performance condition. Even where they did not, the IMF Fiscal Affairs Department stood ready to advise, and its VAT-centered reform prescriptions probably account for the clear resemblances among reforms across the region and the world (Mahon 2004). Autonomous revenue agencies (ARA) became an institutional "best practice" promoted by, among others, the World Bank (Taliercio 2004). The role of international actors was broader than this, of course. Many of the most profound changes took place as part of Brady Plan debt-reduction arrangements after 1988 (Vásquez 1996).

C61.S6

A New Era of Redistribution?

C61.P22 Although the tax and administrative reforms of the past half century did not aim to promote pro-poor taxes and transfers, they left behind states capable of innovating in this direction. On the tax side, apart from income tax reforms such as those in Uruguay and Chile, the main possibilities include new tax designs that offer greater equity without undue sacrifices in efficiency, as well as procedures that involve international cooperation. On the spending side, the growth of revenue has permitted new, modest efforts at poverty alleviation.

C61.S7

New Tax Designs

C61.P23 Three major weaknesses of most current tax systems are the proliferation of exemptions in the VAT, the failure to tax capital income, and the poor state of the cadastral land surveys used for real estate taxation. Happily, in each case many of the same world-historical forces that have made the evasion of capital taxes easier—the advance of information technology, above all—have also facilitated new tax designs.

C61.P24 On the first, the problem is that VAT's in Latin America typically exempt items of mass consumption, especially staple foods, in the interest of equity. But these loopholes attract evasion and cripple the cross-checking function that makes this kind of tax attractive, and in so doing, they make it harder to get sufficient revenue from what are relatively high statutory VAT rates. A proposed solution, dubbed the Personal VAT or P-VAT by its authors, would remove these exemptions after first establishing, via surveys, typical consumption profiles for each decile of the household income distribution. Poorer households would then be issued monthly rebates of the VAT according to the profile for their decile. This would be made possible by the debit-card banking technology used by existing conditional cash transfer programs (Barreix et al. 2012; Corbacho et al., 2013). Rebates could be weighted or combined with other programs, of course. The net result would be a rise in tax revenue due to reduced evasion and, with fewer distortions of incentives, less deadweight loss in the economy.

C61.P25 The other two innovations are more straightforward. Regarding capital income, various observers have advocated the adoption of a dual system for the personal income tax, as was done in Uruguay in 2006. This would impose on interest, dividend, or other capital

income a flat, low rate—perhaps equal to the lowest labor income bracket and the corporate rate. At this level, it could be withheld at the source, saving administrative effort and, most likely, increasing revenue (Corbacho et al. 2013). As for real estate taxes, updates of cadastral surveys and appraisals are now much easier (and progressively cheaper) due to computer-assisted mass appraisal (CAMA), which includes geographic information software (GIS) and global positioning (GPS) technologies (Eckert 2008).

C61.S8 *International Tax Cooperation*

C61.P26 The ability to shift assets and profits to other jurisdictions is a common cause of weakness in corporate income tax (CIT) and capital-income taxation under the personal income tax (PIT). In the past, governments had few tools, and many responded by declaring tax holidays on repatriated assets or, shaping their laws to their capabilities, by simply exempting these bases. Recently, however, an OECD effort to combat base erosion and profit shifting (hence the acronym BEPS) has spurred governments to sign treaties obliging them to share information, especially relating to multinational firms (UN-ECLAC 2017). Here is another example of state capacity being enhanced via international action, in this case characterized by mutual information sharing rather than the adoption of models created elsewhere.

C61.S9 *New Pro-poor Spending*

C61.P27 The simple fact of increased revenues creates the possibility—though not the guarantee—of a significant increase in redistribution. Research on rich countries suggests that consumption taxes constitute a more sustainable funding source for welfare states. The VAT is more productive and less volatile than direct taxes, and a highly productive regressive tax can effectively (by what is sometimes called "Lambert's Conundrum") be equalizing (Lambert 2001; example at OECD 2016, 45). A widely incident indirect tax also obscures the transfer aspect of social welfare beneath its social insurance aspect, aiding political sustainability (Steinmo 1993; Kato 2003; Timmons 2005). The past decade has seen a remarkable spread of social assistance programs in Latin America—most prominently, conditional cash transfers and noncontributory pensions (Barrientos 2013; Garay 2017). However, they still represent a small part of total social spending, and studies of their incidence show that neither are efficiently targeted, with the non-poor making up 39.2 percent of the beneficiaries of the former and 48.6 of the latter (OECD 2016, citing Robles et al. 2015). While public health and education spending are usually quite equalizing in their incidence, most contributory pension systems are not, and other policies—such as fuel price subsidies that benefit the rich disproportionately (OECD 2016)—bespeak a perverse social-policy politics and weak administration.

C61.S10 **Theory, Taxation, and the Latin American State**

C61.P28 How should we think about recent developments in Latin American fiscal policy? As implied earlier, the history of taxation in the region poorly fits the most widely circulated theories of fiscal politics, based mainly on the political development of Europe and other

currently wealthy countries. We find neither a coherent "fiscal contract" story of fiscal states erected (often in wartime) in exchange for administrative law and representation, nor a demonstration of the power of poor "median voters" to impose taxation on the rich (under democracy) in order to benefit themselves. The culprit in each case appears to be the historic weakness of Latin American states. However, the reforms of the past generation might lead us to consider changing this assessment. Before concluding this review, let us step back and consider how.

C61.S11 *Fiscal Contracts*

C61.P29 Fiscal contracting (as in "no taxation without representation") has deep roots in Western political philosophy and practice. As a theory of state formation, it says that the modern state arose from war and the preparation for war, as rulers rationalized administration to extract ever more revenue and mobilize ever more personnel, leveling social differences while demanding more complete cooperation, coordination, and obedience. Revenue extraction (and borrowing) became more predictable and rule-bound and, in return, modes of domination became more circumscribed by law and consultation (Schumpeter 1954 [1918; Ardant 1975; Tilly 1985; Levi 1988; Tilly 1990; Kiser and Hechter 1991; Dincecco 2011).[5]

C61.P30 The history of Latin America obviously diverges from this pattern—not by proving the theory wrong, but by falsifying its major premise. Interstate war has been rare; countries have been independent only for about two centuries; and as these facts might lead us to expect, states have historically been relatively weak. While states involved in rivalries did seem to tax slightly more as a result, the overall pattern reflected the dominance of an elite that seemed to fear the poor of their own countries more than the armies of others (Centeno 2002; Thies 2005). Indeed, in the 20th century, some of the most important state-building moments came about through "contracts" for loans with foreign actors, rather than for taxes with domestic ones. Many South American central banks, budgeting agencies, and controllers of the currency trace their origins to the Kemmerer missions of the 1920s (Drake 1989; Domingo 1995).[6]Here is a historical precedent for the notable external role in tax administration reforms noted earlier.

C61.P31 Yet while much of the initiative and design for recent reforms may have come from without, their content bears the familiar marks of historical fiscal contracts. For Bird and Zolt (2015, 331), "countries can maintain or increase state capacity to collect tax revenues only if taxpayers believe that the funds will be spent wisely." They suggest that the growth of urban middle classes, who have an abiding interest in higher-quality public-sector

[5] Recent work in economic theory turns this historical correspondence into an iron law: Besley and Persson model "fiscal capacity" (taxation) and "legal capacity" (the rule of law) as pure complements (2011).

[6] Edwin Kemmerer (1875–1945) was an American economist who led advisory missions that recommended the creation of institutions supporting sound money and free capital flows, most famously in South America during the 1920s.

provision, makes possible a fiscal pact that trades an improvement in public services for additional taxation. Judging by the historical archetype, such pacts are most likely to succeed if they provide tangible benefits and credible guarantees—in policy, public goods, or institutional changes—to the agents contributing most of the revenues. In Colombia, for example, a small "war tax" on wealth was possible because it built up the security forces, featured mechanisms of oversight by members of the economic elite, and was imposed by a right-wing hero (Flores Macias 2014).

C61.S12 *Median Voters*

C61.P32 The second Latin American anomaly is more serious because it actually violates the expectations of a popular theory. The median voter model, a workhorse in the economics profession, says that taxation and spending are all about redistribution to a ruling group, whether this be a tiny elite under an oligarchy or the majority under an electoral democracy. Because the median voter gets poorer as a government becomes more democratic and a society more unequal, so will democracy and inequality make downward redistribution more likely (Meltzer and Richard 1981). But up to now, the model appears to be egregiously wrong about Latin American fiscal policy. On average, Latin American societies are more unequal than those of any other region of the world; nearly all of the region's governments have been elected with a broad franchise and relatively high turnout for over a generation; and yet they redistribute very little (Profeta and Scabrosetti 2008). Above all, as noted before, these states are notoriously bad at taxing the income or property of the rich.

C61.P33 The median voter model assumes sufficient state capacity to carry out the wishes of the democratic median voter against elite resistance. As with the history of missing fiscal contracts, it would seem that on this point Latin American taxation better fits a model of oligarchic domination (Winters 2011), reflected in an elite preference for a weak state (Cárdenas 2010). If this is right, as long as states remain too weak to tax their richest citizens directly, these have little to fear from democracy (Soifer 2013). Here, the (partial) exceptions illustrate the rule. Just as Chile and Uruguay stand out for having experienced early moments of state formation, in recent years they have had the most substantial progressive tax reforms—arguably due in large part to state capacity. The competence of the Uruguayan tax authority (DGI) in preparing credible incidence estimates for the 2006 tax package helped weaken opposition from those who perceived themselves as "middle class" (Rius 2015). In Chile, protesters championed reforms that reflected widely held confidence in the state administration's capacity to expand education.

C61.P34 As this suggests, things might now be moving in a new direction. Together with the new efforts to alleviate poverty via social spending, Latin American fiscal policy has begun to draw closer to the expectations of the median-voter model. The same policy trends could be regarded as approaching the predictions of a fiscal-contract model more closely, too: insofar as the consumption tax burden falls most onerously on poor and middling

citizens, they might well demand compensation for their side of the fiscal contract. If progressive changes in tax structure remain blocked, they would naturally seek—and under democracy, politicians appealing to the median voter would offer—compensation in the form of spending.

C61.S13 ## Conclusion

C61.P35 Latin American governments do not tax as progressively as do most other governments in the world. The most likely reason is that the region's states have been historically too weak to discover, measure, and enforce tax obligations on their richest citizens and most powerful firms. Nor have taxpayers trusted governments to punish tax evasion evenhandedly or to spend revenues well. The "neoliberal" tax and administrative reforms, enacted with the help of international financial institutions from 1967 to about 2000, did enhance state capacity, chiefly by raising revenue more effectively. They also laid the groundwork for greater confidence in the impartiality of enforcement and the control of spending. In addition, the same technological advances that have facilitated the evasion of taxes on capital assets and income may also aid innovations in taxation that enhance both equity and efficiency. The late commodity boom did underpin the expansion of progressive social spending, but for the most part (excepting Venezuela, mainly), it did so independently of the general increase in state capacity across the region. Although a few mildly progressive reforms of taxation and the spread of modest social programs do not change the overall picture very much, they are a step in the right direction—and bring Latin America closer to what theories of fiscal politics would predict.

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