



TAX REFORM IN LATIN AMERICA: A LONG TERM ASSESSMENT

Vito Tanzi

COMMITMENT TO EQUITY



TAX REFORM IN LATIN AMERICA: A LONG TERM ASSESSMENT¹

*Vito Tanzi*²

CEQ Working Paper No. 15

APRIL 2013

¹ Paper presented at the XXV Regional Seminar on Fiscal Policy, ECLAC, Santiago (Chile), 05-06 March, 2013. An earlier version of this paper was presented at a Conference at the Woodrow Wilson Foundation in Washington in December 2012.

² The author is Honorary President of the International Institute of Public Finance and a former Director of the Fiscal Affairs Department of the IMF.

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 half a century. My first published papers on that topic were in the mid 1960s. My most recent ones were published recently. I also coedited a book on the topic for the IDB, published in 2008, which contained some of my own writing and contributed the introductory chapter 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. Both contain several references to and observations on taxes in several Latin American countries. See references.

Over the last five decades I participated in many tax conferences and tax missions to Latin American countries that ranged from large ones, such as Argentina, Brazil, and Mexico, to smaller ones, such as Costa Rica, Ecuador, 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 three broad questions: first, have there been significant changes, and in a desirable direction, in the tax systems of the Latin American countries, in recent decades? Second, have there been changes in the tax systems of the Latin American countries that may have made them more progressive? In particular, what has happened to the taxation of personal income?

II. LONG-TERM CHANGES IN THE TAX SYSTEMS

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

Half a century ago, the “Declaration of Punta del Este” that created the so-called *Alliance for Progress*, mentioned, as one of the important goals to be promoted by that *Alliance*:

“To reform tax laws [in the Latin American countries], 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...”

At the beginning of the decade of the 1960s, 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, along the lines suggested by the Declaration of Punta del Este. The *Joint Tax Program* (the JTP) was financed and monitored jointly by the UN, the IDB, and the Organization of American States, with US assistance. For more than a decade, until a change in the US administration reduced the US interest in it and its financing, the Joint Tax Program was the main actor in the reform of tax systems in Latin America. For its work, it relied on leading tax experts, from Latin America, the United States, and occasionally from Europe. Its guiding principles were:

- (a) To raise tax levels while making the tax systems more progressive;

(b) To advise Latin American governments to keep *current* government expenditure low, in order to generate *current budget surpluses* to be used to finance *public* investments to create badly -needed infrastructure that, it was then believed, would contribute to the economic growth of the countries;

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

Therefore, (a) the level of taxation, (b) the revenue from income taxes, and (c) the tax incentives were the main variables to influence, in desirable directions, through the tax reforms, economic growth. It should be recalled that this was the time when *Harrod and Domar* and the *Solow's* growth models were very popular. These models gave prominence to the share of investment (both public and private) into Gross Domestic Product, as the main promoter of growth. They assumed that countries that invested a larger share of their GDP in public and private investment would grow more rapidly than those that invested lower shares, *ceteris paribus*. The government was seen to have an obligation to promote growth, by contributing to higher public investment (through higher tax levels and low current public spending) and to higher private investment (through tax incentives and better public infrastructures).

However, 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 income distribution concentrated much of the potential *taxable capacity* among the higher percentiles of the income distribution, and especially among the top five percent of the income recipients. For statistical evidence see Tanzi, 1966 and 1974. The uncomfortable truth is that, the Gini coefficients for most Latin American countries, have not changed significantly, since that time. They have remained stubbornly high and generally higher than in most other regions of the world, in spite of recent reported improvements in a few countries.

In the early 1960s, the personal income tax was very popular and, in surveys of the US population, it was considered the "fairest of all taxes". At that time it was also highly progressive and was expected to generate a large share of the total tax revenue of countries, as it did in the USA. That thinking, that was prevalent in the United States and in Europe, inevitably influenced the work of the Joint Tax Program. Through various technical assistance missions to Latin American countries, and through other activities, such as important conferences and publications of books and reports, the Joint Tax Program tried to introduce, in Latin America, income taxes that were similar to the "individual income tax" and the "corporate income tax" that, at that time, existed in the United States.

However, the progress in this area at that time remained limited, mainly because of political opposition to income taxes by higher income groups in the Latin American countries that had much of the political power and because of administrative difficulties, in part due to limited financial resources, and to some structural characteristics of the economies that made income taxation more difficult.

In the late 1970s and in later years, when the Joint Tax Program was no longer in operation, the intellectual climate changed and tax reforms and especially reforms aimed at making tax systems more progressive lost their appeal. The objective moved from equity to stabilization and growth and "tax incidence studies" of countries that had been very popular in earlier years were no longer produced.

Let me now move from the decade of the 1960s to the present, focusing on the tax levels and on the tax structures, in that order.

i Changes in Tax Levels

Various recent papers and especially a highly informative paper, by J. C. Gomez Sabaini and J. P. Jimenez, prepared at CEPAL (2011), have summarized much of the statistical information that has become available in recent years, on tax levels as shares of GDPs and on tax structures for Latin American countries. For convenience, I shall refer to the mentioned paper for parts of my forthcoming discussion.

As a paper by Gomez Sabaini and Jimenez 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, that lower the average tax burden for the Latin American countries, these authors give the impression of being disappointed by the progress made by the Latin American countries in raising the tax burden.

I do not share their disappointment and would make several pertinent observations on their conclusion.

First, the recent tax burdens of several Latin American countries, as percentages of their GDPs, are at levels much higher than they were in the past and at levels comparable, or higher, than those that had prevailed in the so-called industrial countries until around the time of the Great Depression, in the 1930s, and the Second world War. For example, in 1929 the tax burden for the US *general* government was only about ten percent of GDP, and much of that was collected at sub-national level by the local governments. In 1940, the tax burden of Sweden, the country that today has the second highest tax burden in the world, was still only around 15 percent of GDP. Even in 1960 the tax burdens of Spain, Switzerland, Portugal and Japan were still less than 20 percent of GDP. See Tanzi, 2011.

Second, today’s tax burdens in Brazil and Argentina are significantly higher than the tax burden of the United States and, in the United States, there are a lot of complaints, from a large part of the citizenry, about their presumed high taxes, and especially about the taxes paid by those with higher incomes. The high income exemptions and deductions limit the taxes on the lower part of the population and because of the lack of a value added tax means that lower income groups contribute little to the tax payments surely much less than the lower income groups in Brazil and Argentina.

Third, if the tax burdens of the different South American countries were weighted by the countries’ populations, they would be seen to have gone up a lot, in recent years because they went up significantly especially in the countries with high populations, such as Brazil and Argentina. In Brazil, for example the average tax burden more than doubled since the decade of the 1970s. In Argentina the level of taxes also increased sharply. The large share of Brazil and Argentina in the total populations of South America implies that a much larger share of the Latin American *population* is now paying much higher taxes than in the past. See Tanzi, 2007 and 2010. Giving the to the individual countries a weigh that reflected their populations, and keeping in mind that, because of the lack of progressivity in these payment of taxes, the tax burden on

large sectors of the populations of Brazil and Argentina has increased a lot. It is, therefore, likely that *for the majority of the population*, and not *for the majority of the countries*, the tax burden is now higher in South America than in North America (i.e., that is for the population of the USA, Canada, and Mexico combined). It should not be forgotten that it is people that pay taxes not countries! As a thought experiment to make this point, if Brazil were to split into two countries, the average tax burden of the South American countries would increase; if Guatemala were to split into two countries, the average tax burden for the region would fall, *ceteris paribus*. This means that averages for groups of countries, that ignore the sizes of the countries, fail to provide a realistic view of the tax burden on the *majority* of the population.

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 the natural resources. Because of these *rents*, they can finance higher spending with their own resources than indicated by their tax revenues. If these natural resources were privatized and if the new private owners paid to the government taxes equivalent to the current "rents", there would be no questions that the "rents" should be classified as taxes.

Finally, it should never be forgotten that a higher tax burden is not always preferable to a lower tax burden, as some of the studies, including the one by Gomez Sabaini and Jimenez, seem to imply. 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 largely wasted in projects with low economic productivity, or when it is wasted 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 pockets of the taxpayers. This is even more the case when the tax systems are not progressive but broadly proportional, so that lower income individuals pay taxes similar to those of individuals in higher income classes. This is likely to be the case in Brazil where because of the lack of progressivity of the tax system, low -income groups are now paying significantly high taxes. This is likely to be the case also in Argentina and in some of the other high tax burden countries. For some elaborations of this argument, see Tanzi, 2008a. When there are doubts about the productive and socially desirable use of tax revenue, and especially when the taxes collected are not obtained with progressive taxes, the presumption should be in favor of lower tax revenue.

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* that are of widely different sizes). In comparisons of this kind one should not give the same weight to Brazil and, say, Honduras or Guatemala. As a conclusion, it is likely that a larger *share* of the *population* (and not of the *countries*) of Latin America is now subjected to higher tax burdens than the population of the OECD countries.

ii Changes in Tax Structures

From a *superficial* look at the tax systems of the Latin American countries, it would be easy to conclude that there has been little change in tax structures over the years in the region. To a large extent indirect taxes were replaced by other indirect taxes, while the share of income and wealth taxes in total tax revenue changed little. However, the superficial look would be based on a wrong impression. As with icebergs, the

changes may often take place below the visible part of the tax systems and, thus, may not be immediately noticeable.

With a closer look, it could be maintained that the changes that took place over recent decades, in the tax systems of many Latin American countries, have made those tax systems far better in terms of resource allocation and in some other aspects than they had been in the past. The reason for this affirmation is that, in terms of the 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. However, in terms of vertical equity the changes are likely to have been less desirable.

In recent decades, remarkable and broadly positive changes took place, especially in indirect taxes. See Tanzi, 2008b for a description of some of these changes. 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 collected with very high tax rates (used as highly distorting protective devices for domestic industrial activities) have been largely replaced by, much more allocation-neutral value added taxes, and by lower import duties. The taxes on exports, that used to be common in several countries in the past -- see Tanzi, 1976-- have largely, though not entirely, disappeared. The great proliferation of tax incentives that existed in the past has been largely reduced. Finally, especially the introduction of widely -based value added taxes has represented a tectonic change in taxation. 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, anecdotal example of the change that has occurred in the use of value added taxes. 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 less than 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 the value added taxes was even higher, 13 percent of GDP, although some of the revenue collected does not come from a "clean" VAT.

These are percentages that would qualify the above countries for world records! They indicate important legislative changes but also, importantly and indirectly, that the Latin American tax administrations have become far more efficient than they had been in the past. Two other countries, Uruguay and Chile, collect around 8 percent of GDPs from the VAT, and several others more than five percent of their GDPs. These revenues come from a tax that practically did not even exist in Latin America in the decade of the 1960s, and that was collecting little revenue until the decade of the 1990s!

A value added tax is, in principle, a much better instrument, for both stabilization policy and for the allocation of resources, than the taxes that it replaced, especially when it is applied on a wide base and with a

single rate. However, its increasing importance is not likely to have made the tax systems more progressive than they were, in spite of attempts by several governments, and especially by the Mexican government, to exempt from it products and services that are assumed to be more important to individuals from low income groups in order to make the VAT more equitable. However, the value added taxes generally replaced taxes that, in spite of the distortions in the allocation of resources that they had created, had been intended to be paid by people at higher income levels, with taxes that are broadly proportional to consumption, and that are thus paid by almost everyone. Thus, to some extent, the success of the VAT in the Latin American countries has shifted the tax burden toward the lower income groups and as a consequence it has increased the desirability of relying more on progressive personal income taxes, to make the tax systems more equitable.

The dramatic increase in the share of total tax revenue coming from the value added tax is also indirect evidence that the tax administrations of the Latin American countries have improved over the years, perhaps more than it is realized and recognized. The value added tax is not an easy tax to administer. The improvement in the tax administrations has been partly due: (a) to the use of computers; (b) to use of better administrative techniques; (c) to the availability of more resources and better incentives for the tax administrations; and (d) to reductions, compared to the past, in interference by politicians with the work and the decisions of the tax administrations.

At the same time, there have been increasing difficulties for tax administrations coming from the progressive globalization of economic activities and from the growing role of tax havens that have created different difficulties than those that were common in the past, for the tax administrations. For example, the use of transfer prices in cross countries' dealings has created major difficulties. See Avi-Yonah, 2008, and Mercader and Pena, 2008. These difficulties have created what the author of this paper has defined as "fiscal termites", " termites" that have been eroding tax bases and creating increasing difficulties for tax administrators. See Tanzi, 2001, and 2008b. Therefore, from the above, it should not be concluded that the tax administrations of the Latin American countries have become examples of high efficiency. As the tax administrations in other parts of the world, they have improved but are facing new challenges. It simply means that they are more efficient now than they used to be decades ago. Tax evasion remains a problem, especially in some countries, and over the years it has acquired a more global and less national dimension.

The available estimates of tax evasion, as for example those reported in the mentioned study by Gomez Sabaini and Jimenez, 2011, or in the study by Cornia et al. 2011, while useful, should be assessed with caution, because, if taxes are difficult to collect, it must be equally difficult to estimate how much of the taxes not collected are evaded. The national accounts, or even the household surveys, that are used to estimate tax evasion, may be in part "cuentos nacionales", or national "fairy tales", as Latin American cynics used to say in the past about the national accounts data of their countries. They may contain large errors.

Over the years, the tax administrations have experimented with various techniques and organizational changes to increase their efficiency. Some of these included the use of, (a) "punto fijo" techniques, (b) "large taxpayer units", (c) various forms of "simplified taxes" and other presumptive methods to collect taxes, (d) lotteries for taxpayers who pay their taxes, (e) requirement for sellers to issue invoices; or for consumers to ask for them, (f) advance withholding payment for some taxes, (g) reorganization of tax administrations by functions, rather than by tax, (h) systemic rotation of tax inspectors, (i) surveys of taxpayers, to flush out

corrupt tax inspectors in some areas, (k) sharing, with the tax administrations, the additional tax revenue collected, to create some incentives for the administrations, (l) better salaries and more meritocratic promotions and hiring, and so on. Additionally the increasing use of computers, to store or retrieve information, has been important. Some of these techniques or reorganizational changes have been failures; but some have contributed to the good results that have led to the increases in the tax revenue mentioned earlier.

This may also mean that the revenue effects of the tax evasion, that is often mentioned by those who write on taxation, have in part been neutralized, or at least reduced, *in a macroeconomic sense*, by extra efforts in other areas. For example, tax evasion on a specific tax, say evasion for the personal income tax, may in part be neutralized by the use of other taxes, taxes that would not have been introduced if there had not been the tax evasion in the first place. In a macro sense, the revenue lost because of tax evasion in one tax may be made up by the use of other, easier to collect, taxes. For example taxes on cars and on gasoline, or value added taxes, may make up for revenue losses on income taxes. This means that the *statutory* tax systems would be different if there were no tax evasion. Therefore, the estimates of tax evasion reported, apart from their reliability, suffer from problems common to partial equilibrium analyses. But, of course, because of the tax evasion, some taxpayers gain or lose more than some others, while a country's citizens lose, because the country ends up with a tax system that is different from the one that the government would have chosen, if tax evasion had not been a consideration.

In conclusion, tax evasion is *always* a problem of equity and of allocation of resources, but *may not always* be a macroeconomic problem (one of revenue losses) if the revenue losses due to tax evasion in some taxes can be made up by the use of other taxes as it seems to have happened to some extent in some Latin American countries.

III. ON THE REVENUE CONTRIBUTION OF INCOME TAXATION

Up to the 1980s, and after the attempts made in the 1960s, the taxation of income had changed relatively little in Latin America. High inflation, combined with long collection lags, and with the distortion of tax bases due to inflation, had often had a significant, negative, impact on income tax revenue. See Tanzi, 1977. The statistics now available indicate that, in the first decade of the new millennium, when, in most countries inflation was no longer a problem, there were significant increases in the revenue from income taxes in some countries. However, much of the additional revenue came from taxes on the income of corporations. Income taxes on individuals have continued to contribute little to tax revenue.

Tables, in the paper by Gomez Sabaini and Jimenez (Table 8, p. 27) and in Cornia et al. (Table 15, p. 35), provide some data for the revenue from individual and corporate income taxes, for the years 2004-2007. The highest revenue, from the taxes on the incomes of *individuals*, was obtained by Brazil – but it was a relatively miserly 2.6 percent of GDP. Mexico and Panama also got revenue of about two percent of GDP. The average for Latin America was 1.4 percent, compared with 9.2 percent for the OECD, and much higher percentages for many of the OECD in Europe. By contrast, the revenue from *corporate* income taxes averaged 3.6 percent of GDP, almost the same as in OECD countries, for which the average was 3.9

percent of GDP. Chile (with 7.3 percent), Peru (with 5.9 percent), and Brazil (with 5.1 percent) got more than five percent of GDP from their corporate income taxes. This was a very high level. In these countries, and especially in the first two, corporations that dealt with the production and the export of mineral resources must have been the largest contributors to the corporate income tax revenues.

The very low contribution of personal income taxes to total tax revenue, accompanied by the low taxes on wealth, almost guarantees that the tax systems of the Latin American countries would contribute little to the lowering of the pre-tax Gini coefficients. This conclusion is empirically supported by a table, (Appendix Table 1 on page 39), in the Cornia et al. paper. That table has estimated that taxes play almost no role in changing the Gini coefficients in most Latin American countries, while they play a much more significant role in European and in Anglo-Saxon countries. See Tanzi, 2011, p. 27, Table 1.5. Among the Latin American countries, the Argentine tax system is estimated to be the most redistributive. In conclusion, Gini coefficients continue to be very high in Latin America. Redistribution through tax policy is almost non-existent in the region. This means that the higher are the tax burdens the higher are the burdens on those at the lower end of the income distribution. See also Table 7, p. 27 of the Gomez Sabaini and Jimenez paper. This can be seen as an argument against raising too much the tax burdens as long as the increase is made with proportional taxes and as long as the public spending is not characterized by efficiency and by equity.

Redistribution through the spending side of the budget is low, especially when compared with OECD countries, as various papers by several scholars have shown, even though some recent programs, in Brazil, Mexico, Panama, and other countries, have started to make some difference. However, the available estimations of the incidence of fiscal policy may exaggerate the redistribution that taxes and public spending generate, especially in the Latin American countries. There are two main reasons for this observation.

The first is that the calculations made for the impact of *taxes* on Ginis do not take into account the *compliance costs* of taxation that, in several countries for which there are estimates, are high and regressive. See Tanzi, 2012a. As shares of the incomes of taxpayers, the compliance costs tend to be higher for lower income taxpayers. The complexity of the tax systems contributes to this result. However, it is difficult to determine whether this result is as valid for Latin American countries, which may rely less on complex personal income taxes, than in more advanced countries. At least for Brazil, several studies by the World Bank and some other institutions have shown that compliance costs are very high, because of the high complexity of the tax systems. However, it is less clear whether they are higher for lower income individuals as they tend to be in more advanced countries

The second and more important reason, that biases the results on the spending side of the budget, especially for Latin American countries, is the *inefficiency* and the *corruption* that often accompanies government spending and various government programs. The costs of inefficiency and corruption are not proportionally distributed among the population. This is an aspect that has attracted little attention on the part of scholars. But see Tanzi, 1974, for a detailed description of it in Latin American countries. This aspect is likely to be more important in poorer countries than in richer countries. Because of inefficiency and of corrupt practices, on the part of those who deliver the public services (educators, public health officials, and so forth) the *real*, valuable benefits that the citizens receive from some government spending (from the transfer programs), that in the methodology usually used by scholars are equated to the budgetary costs of the programs and are allocated totally to those who receive the services (school children, patients in health

clinics, etc.), This exaggerates the benefits that they receive. Because of the significant leakages in the delivery of the services due to inefficiency and corruption, the real benefits received by the citizens, and especially by the poorer ones among them, are likely to be less, and at time much less, in real value, than the government spending. Those who deliver the services (school teachers, nurses, administrators), who generally do not come from the lowest percentiles in the income distributions, may absorb the (often large) difference. They are the beneficiaries of the leakages from money spent and real benefits received. This may occur because of underperformance, or because of corrupt practices. For example teachers or nurses may frequently not show up, as often as they are supposed to, or may appropriate some of the supplies. Administrators may divert some of the funds. See Tanzi, 1974 and 2008, for a discussion and some evidence of this point.

Returning to income taxation, a logical question to ask is why the Latin American countries have been so successful in raising revenue from the value added taxes, that are taxes not easy to administer, and so unsuccessful in raising revenue from the individual income taxes? How could the tax administrations have improved their efficiency so much in one tax and so little in the other? The answers given by experts to this question are not convincing. They include: (a) the high degrees of informality in the economy; (b) the low incomes and tax bases; (c) the presumed high tax evasion; (d) administrative corruption; and so on. But why are these more significant for the personal income tax than for the value added tax?

This writer is convinced that, at least in part, the answer is elsewhere, and is a much simpler one. It has to do with two factors. First, with the very low shares of total national income, that in the Latin American countries go to wages and salaries of dependent workers, compared with more advanced countries. Second, to the low tax rates that are applied on all incomes but, especially, on the incomes that are **not** derived from wages and salaries. See Tanzi, 2008c. To these two factors one could add that the levels of personal exemptions from income taxes are remarkably high in Latin American countries, thus helping to wipe out a large part of the tax base for the personal income tax.

In Latin American countries, the shares of national income received by dependent workers in the form of wages and salaries are unusually low, often less than 30 percent of the total. These shares are much lower than in most industrial countries, where they often exceed 60 or even 70 percent of total income. In Latin America, an overwhelming share of national income is received in the form of rents, dividends, interest payments, profits, capital gains, or is received, as informal incomes, by individuals who make their living in the informal economy and who do not receive incomes high enough to be taxable. Much of the potentially taxable money is received in the above -mentioned forms. This is the first part of the explanation, for why individual income taxes are so low in Latin America.

The second part is that, as I described in some detail in a recent paper, (see Tanzi, 2012b), there has been, in the USA, over the last three decades, a process that has led to the progressive *dismantling* of the earlier *architecture of the income tax*, that, in the past, had been based on the Haig –Simon concept of income. The traditional Haig-Simon (or for that matter the concept suggested by Hicks) had assumed that all incomes, regardless of the sources, created capacity to consume and are thus the same. As a consequence, they should be treated equally, because they provide spending options for those who receive them. It follows that they should be taxed in the same way, and, possibly, with progressive rates, on their aggregated, or “global”, total.

This was the concept of the progressive and comprehensive personal income tax that had prevailed until the 1970s.

However in recent decades, starting in the 1970s, the Haig –Simon concept of taxable income started to be attacked by various economic theorists. Over the following two decades, the *architecture of the income tax* was progressively dismantled, because of various, and at times questionable, theoretical arguments. It was replaced by an architecture that made sharp distinctions among different types or sources of income, and that gave special treatment to particular forms of income, such as dividends, capital gains, “carried trade incomes”, and so on. This change in the architecture of the personal income tax helps to explain how Governor Romney could pay a tax of only 13 percent, as he declared during the recent presidential campaign, on an income reported to be many millions of US dollars, and presumably without having evaded the taxes due.

Because of the influence that US thinking has on Latin American policymakers, who have often studied in US universities, the change in the architecture of the individual income tax must have influenced their tax systems leading to (a) lower tax rates on income in general (see Gomez Sabaini and Jimenez, 20011, p. 25) and (b) to even lower rates on the personal income, generally received by richer individuals, in the form of dividends, interest income, capital gains, profits, rents, etc. See Table 4.2, p.116, of Velayos, Barreix and Villela, 2008, for some evidence.

If a smaller share of a total income (30 percent versus 60-70 percent) is taxed at normal rates, if the personal exemption for that income is high, and if the larger share (the 60-70 percent) is taxed at very low rates, it should be no surprise that the total tax revenue obtained from taxes on individual incomes will be small. Tax evasion might be of some help in explaining this result, but it is unlikely to be the main explanation.

It can be theorized that the improvements in tax administrations that took place over the years in Latin America, and that could have led to higher revenue from individual income taxes, were partly neutralized by the reductions in the tax rates on the incomes of the richer taxpayers, that were occurring in those years. It would be a worthwhile project for CEPAL, or for some other institution, such as the IDB, the World Bank , or the IMF, to collect the data that would make it possible to test this hypothesis.

IV. 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 on the quality of the public services in many Latin American countries, I am not sure that the progress made on the spending side of the budget has been equally good, in spite of some recent, worthwhile programs directed specifically toward the poor in a few countries.

It is important 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. This is especially the case when the tax revenue has not been collected with progressive taxes, but with taxes that are broadly proportional but that suffer from significant horizontal inequities. Doubts remain whether the revenue obtained in Latin American countries are always used in the best way possible. See Tanzi, 2008a.

REFERENCES

- Arnson, Cynthia J. and Marcelo Bergman, 2012, "Taxation and Equity in Latin America", Woodrow Wilson Center Update on the Americas (June).
- Avi-Yonah, Reuven S., 2008, "Globalization and Tax Competition: Implications for Developing Countries", in Tanzi, Barreix and Villela, editors.
- Bernardi, Luigi, Alberto Barreix, Anna Marenzi and Paola Profeta, editors, 2008, Tax Systems and Tax Reforms in Latin America (London and New York: Routledge).
- Corbacho, Ana, Vicente Fretes Cibils, Eduardo Lora, forthcoming, More than Revenue
- Cornia, Giovanni Andrea, Juan Carlos Gomez-Sabaini and Bruno Martorano, 2011, "A New Fiscal Pact, Tax Policy Changes and Income Inequality", UNU-WIDER, Working Paper No. 2011/70.
- Gómez Sabaini, Juan Carlos, and Juan Pablo Jiménez, 2011, "Tax Structure and Tax Evasion in Latin America," CEPAL, Series macroeconomía del desarrollo, 118, December.
- González Cano, Hugo, 2006, "Experiencia del Impuesto a la Renta Personal de Argentina, Brazil, Chile y otros Países de la Region y Europa", mimeo (January 1).
- Goode, Richard, 1962, "Personal Income Tax in Latin America" in Joint Tax Program, AOS, IDB, ECLA, Fiscal Policy for Economic Growth in Latin America (Johns Hopkins Press).
- Jorratt Michael, 2011, "Evaluando la equidad vertical y horizontal en el impuesto al valor agregado y el impuesto a la renta: el impacto de reformas tributarias potenciales. Los casos del Ecuador, Guatemala y el Paraguay". CEPAL, Series macroeconomía del desarrollo, 113 (June).
- Lustig, Nora, 2012, "Taxes, Transfers and Income Redistribution in Latin America" Inequality in Focus, The World Bank, Volume1, Number 2 (July).
- Mahon, James E., Jr, 2012, "Tax Incidence and Tax Reforms in Latin America", Woodrow Wilson Center Update on the Americas" (November).
- Mercader, Amparo and Horacio Pena, 2008, "Transfer Pricing and Latin American Integration", in Tanzi, Barreix and Villela, editors.
- OECD, 2011, Revenue Statistics in Latin America, 1990-2009 (Paris: OECD).
- Tanzi, Vito, 1966, "Personal Income Taxation in Latin America: Obstacles and Possibilities" National Tax Journal, Vol. XIX, No. 2.
- , 1968, "Incentivos Fiscales para el Desarrollo Economico de America Latina", Investigacion Fiscal, May.

- , 1969, “Tax Incentives for Economic Development: The Ecuadorian Case” Finanzarchiv (March).
- , 1972, “Fiscal Reform in Colombia: The Report of the Musgrave Mission”, Inter-American Economic Affairs (Summer).
- , 1974, “Redistributing Income through the Budget in Latin America”, Banca Nazionale del Lavoro Quarterly Review, (March).
- , 1976, “Export Taxation in Developing Countries: Taxation of Coffee in Haiti”, Social and Economic Studies (March).
- , 1977, “Inflation, Lags in Collection, and the Real Value of Tax Revenue”, IMF Staff Papers, March.
- , 2001, “Globalization, Technological Developments and the Work of Fiscal Termites”, Brooklyn Journal of International Law, Vol. XXVI, no. 4.
- , 2007, Argentina: an Economic Chronicle (New York:Jorge Pinto Books)).
- , 2008a, “The Role of the State and Public Finance in the Next Generation”, OECD Journal of Budgeting.
- , 2008b, “Globalization, Tax Systems, and the Architecture of the Global Economic System” Chapter 13 of Taxation and Latin American Integration, edited by Tanzi, Barreix and Villela .
- , 2008c, “Tax Systems and Tax Reforms in Latin America”, Introductory chapter to the book edited by Bernardi et al.
- , 2008d, “Trade Liberalization and Fiscal Balances: Exploring Obvious and Less Obvious Channels”, in Tanzi et al, 2008.
- , 2010, The Charm of Latin America (New York:iUniverse).
- , 2011, Government versus Markets: The Changing Economic Role of the State (Cambridge University Press).
- , 2012a, “Tax Complexity: origins and implications”. Mimeo. Available from author.
- , 2012b, “Taxing the Big”. Mimeo. Available from author.
- Tanzi, Vito, Alberto Barreix and Luiz Villela, editors, 2008, Taxation and Latin American Integration (Harvard University).
- Velayos, Fernando, Alberto Barreix and Luiz Villela, 2008, “Regional Integration and Tax Harmonization: Issues and Recent Experiences”, in Tanzi, Barreix and Villela, editors.



WHAT IS CEQ?

Led by Nora Lustig (Tulane University) and Peter Hakim (Inter-American Dialogue), the Commitment to Equity (CEQ) project is designed to analyze the impact of taxes and social spending on inequality and poverty, and to provide a roadmap for governments, multilateral institutions, and nongovernmental organizations in their efforts to build more equitable societies. CEQ/Latin America is a joint project of the Inter-American Dialogue (IAD) and Tulane University's Center for Inter-American Policy and Research (CIPR) and Department of Economics. The project has received financial support from the Canadian International Development Agency (CIDA), the Development Bank of Latin America (CAF), the General Electric Foundation, the Inter-American Development Bank (IADB), the International Fund for Agricultural Development (IFAD), the Norwegian Ministry of Foreign Affairs, the United Nations Development Programme's Regional Bureau for Latin America and the Caribbean (UNDP/RBLAC), and the World Bank. <http://commitmenttoequity.org>



**COMMITMENT
TO EQUITY**

The CEQ logo is a stylized graphical representation of a Lorenz curve for a fairly unequal distribution of income (the bottom part of the C, below the diagonal) and a concentration curve for a very progressive transfer (the top part of the C).