Tax Reform In Latin America: A Long-Term Assessment*

By: Vito Tanzi**

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 Peru, 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 that may have made them more progressive? In particular, what has happened to the taxation of personal income?

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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, measured as shares of GDPs, or for the structure of the tax systems.

More than 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. It was nested within the OAS. 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 advice Latin American governments to keep current government expenditure low, in

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The Program’s work on democratic governance focuses on questions of improving democratic quality and state capacity, the relationship between democratization and internal armed conflict, the resurgence of populism, and the protection of human rights. It also explores the impact of public policies to promote social cohesion and address the region’s persistently high inequalities. The Program’s current approach builds on three decades of prior work on democratic governance at the Wilson Center, including path-breaking studies of the breakdown of democratic regimes, transitions from authoritarianism, challenges to the consolidation of democratic rule, decentralization, and the fostering of citizenship and socio-economic inclusion.

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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 and through tax reforms, economic growth. It should be recalled that this was the time when Harrod and Domar’s and the Solow’s growth models were very popular with economists. These models gave prominence to the share of investment (both public and private) into Gross Domestic Product, as the main promoter of economic growth. They assumed that, ceteris paribus, countries that invested a larger share of their GDP in public and private investment would grow more rapidly than those that invested lower shares. 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 at that time 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 on this observation 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 a very popular tax and, in surveys of the US population, it was considered by a wide margin 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 the Latin American countries, 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 political interference, and to some structural characteristics of the economies that made income taxation more difficult in Latin America than in the USA and Europe.

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. See Tanzi, 2012b. The main 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.

**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 the 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 burdens.

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 income 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 share 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 that exist in the USA limit the tax burden on the lower part of the population and because of the lack of a value added tax means that lower income groups contribute relatively little to the tax payments, surely much less than the lower income groups in Brazil and Argentina where the taxes are much less progressive.

**Third**, if the tax burdens of the different South American countries were weighted by the countries’ populations, and not averaged among countries of widely different sizes, they would be seen to have gone up a lot, in recent years because they went up significantly especially in the countries with large populations, such as Brazil and Argentina. In Brazil, for example, the average tax burden increased by two and a half time since 1950, when it was only 14 percent of GDP, to reach the current level of around 35 percent. In Argentina the level
of taxes also increased sharply and the tax burden more than doubled over the years. The large share of the population of Brazil and Argentina in the total populations of South America implies that a much larger share of the Latin American total population is now paying much higher taxes than it was in the past. See Tanzi, 2007 and 2010. Once the individual, Latin American countries are given weights that reflect their populations, and once we keep in mind that the taxes are not collected in a progressive fashion but are largely proportionally, we cannot but conclude that taxes have increased a lot on much of the population of Latin America. 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 or several countries, and the tax burden of the region were estimated in the traditional way that gives equal weight to all 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 and give equal weight to all, fail to provide a realistic view of the tax burden on the majority of the population, that should be the relevant variable.

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, and, 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. It also depends on the progressivity of the tax burden assuming that there is diminishing utility to income. 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 refrain from praising governments for their extra fiscal efforts. In these circumstances, it would be 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 tax burdens 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. It is likely to be also the case 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 with 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 comparable share of the population of the OECD countries.

**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 wrong impression. As with icebergs, the changes may often take place below the visible part of the tax systems and, thus, may not be easily 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 these 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 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 devises 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 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 mostly 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 still 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. 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 countries 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 Table1 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 focused on the poor, in Brazil, Mexico, Panama, and some 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 complexity of the tax system. 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, due to 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, such as educators, administrators, public health officials, and so forth, the real value of the benefits that the citizens receive from some government transfer programs—that in the methodology usually used by scholars are assumed to be identical to the budgetary costs of the programs and are thus allocated totally as benefits to those who receive the services (school children, patients in health clinics, etc.)—-, exaggerate the benefits that they receive. Because of the significant leakages in the delivery of the services, due 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 cost of 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 to 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 or may work at a too leisurely pace. Administrators may divert some of the funds to personal or other uses. See Tanzi, 1974 and 2008a, for a discussion and some evidence of this point.

Returning to income taxation, an obvious 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 often do not receive incomes high enough to be subject to taxation. 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 John Hicks) had assumed that all incomes, regardless of their sources, created capacity to consume and should thus be taxes in the same way. They should be treated equally, because they provide spending capacity for those who receive them and 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 the 1970s and in later years, 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 explain how Governor Romney could pay a tax of only 13-14 percent on an income of 12 million dollars, as he declared during the recent presidential campaign, and, presumably, without having evaded the taxes due.

Because of the influence that US thinking has on Latin American policymakers, many of whom have studied in US universities, the change in the architecture of the individual income tax must have influenced their tax systems leading (a) to lower tax rates on income in general (see Gomez Sabaini and Jimenez, 2001, p. 25) and (b) to even lower rates on personal income more often received by richer individuals such as 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 lower rates; if the personal exemption for that income is high; and if the larger share (the 60-70 percent) of income received is taxed at very low rates, it should be no surprise that the total tax revenue obtained from individual incomes taxes 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.

**Concluding Remarks**

There is little doubt in my mind that over the last 50 years 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 Latino-barometro 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 to 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 is not collected with progressive taxes, but with taxes that are broadly proportional but that, because of tax evasion, suffer from significant horizontal inequities. Doubts remain whether the revenue obtained in Latin American countries are often used in the best way possible. See Tanzi, 2008a.

An earlier version of this paper was presented on December 11, 2012, at a Wilson Center conference entitled, “The Political Economy of Tax Reform in Latin America”. To watch the webcast and access the presentations, click the following link: [http://www.wilsoncenter.org/event/PolEcon_TaxReform](http://www.wilsoncenter.org/event/PolEcon_TaxReform).

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