

Progressivity and Regressive Taxation in Latin America: An Overview

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Economic Commission for Latin America and the Caribbean



UNITED NATIONS

TAXATION AND EQUALITY IN LATIN AMERICA
Woodrow Wilson International Center for Scholars
Universidad de San Andrés

ECLAC

May 24 2011, Washington D.C.

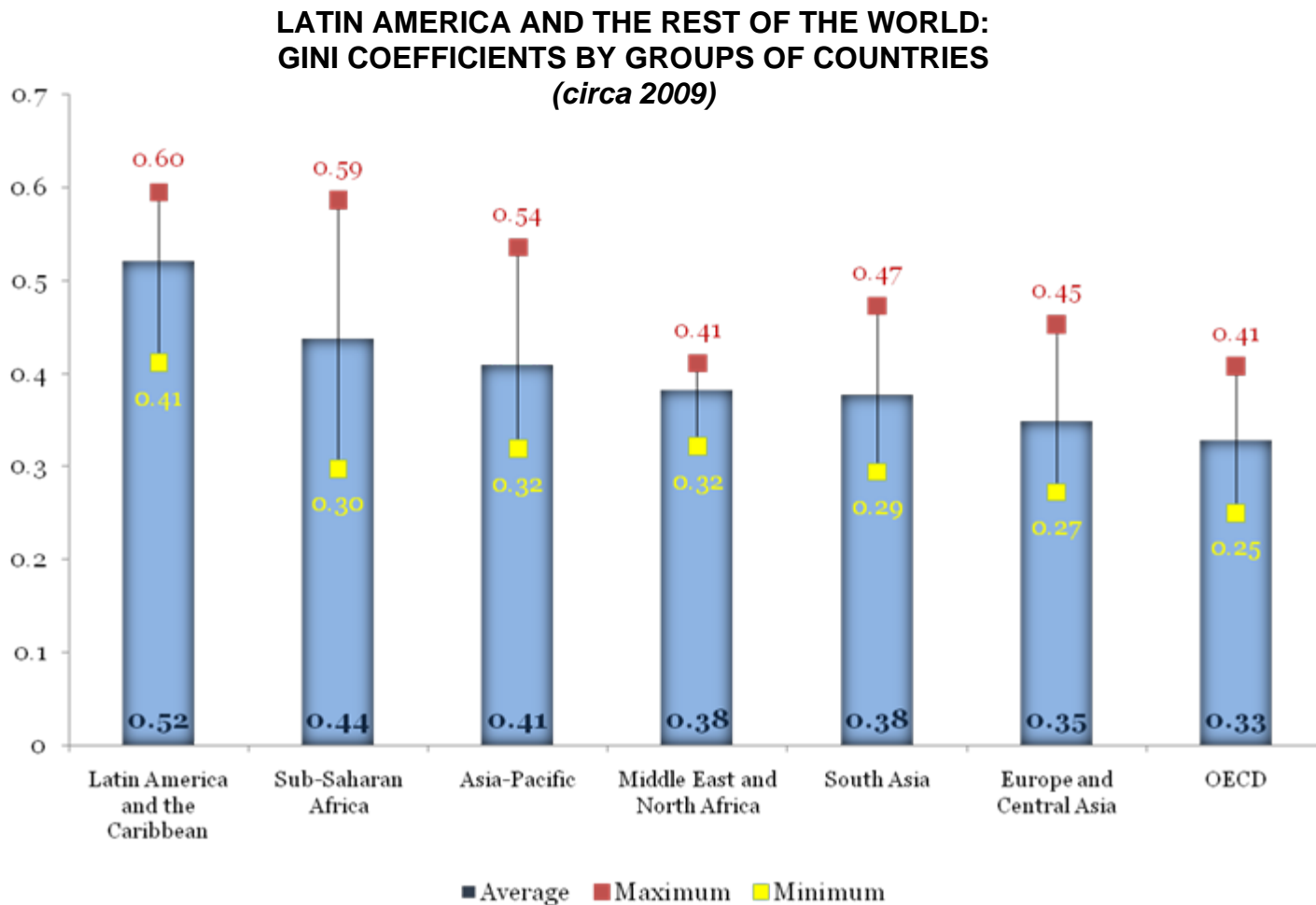
Overview

- I. Objectives of the presentation
- II. Main characteristics of Latin American inequality.
- III. The role of tax policy on income distribution.
- IV. Conclusions and future challenges.

Main characteristics of Latin American inequality

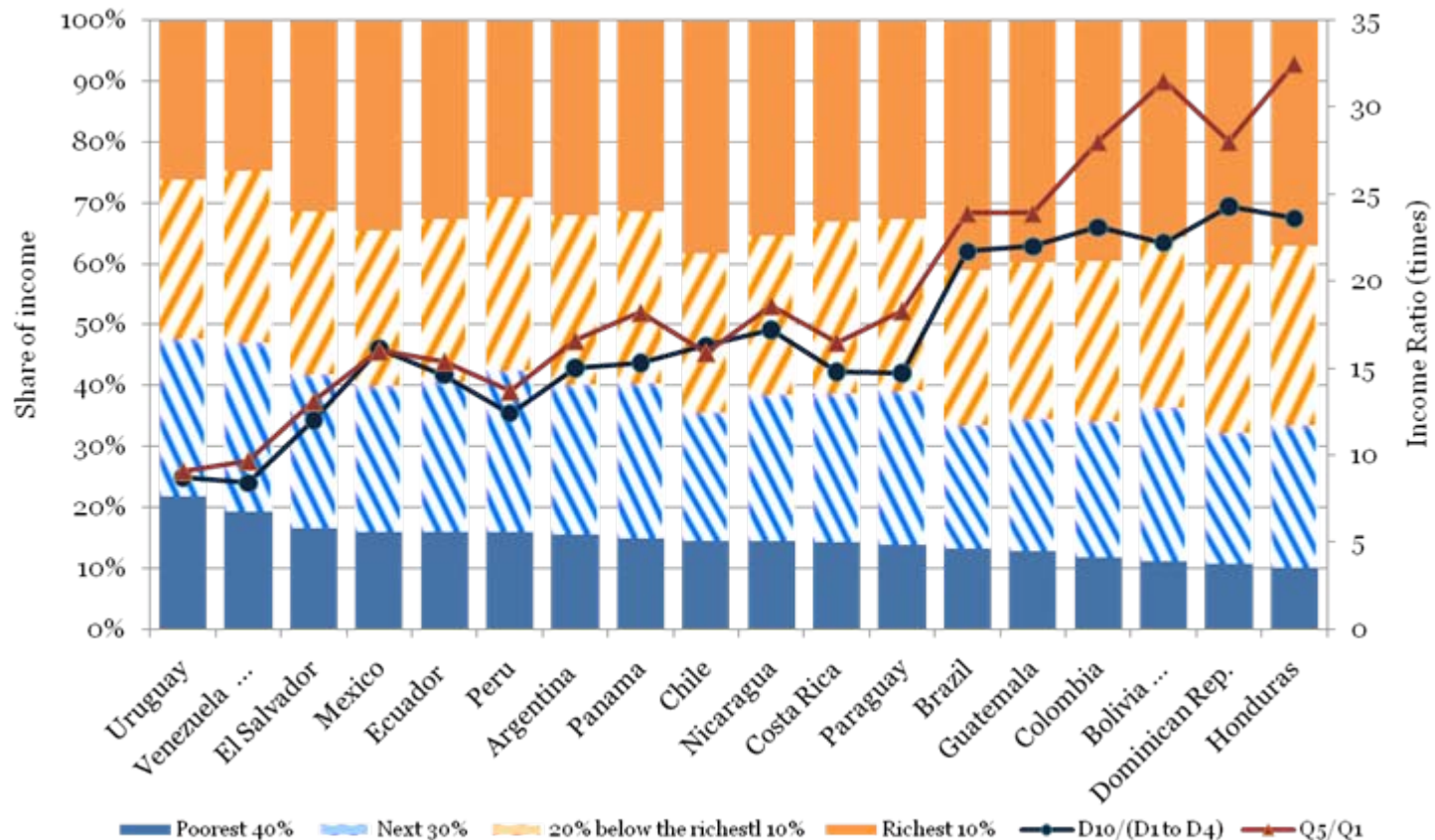
- **High Concentration**

Latin America is singled out due to its high income inequality



Fragmented societies in which a large fraction of total income is captured by the richest 10%

STRUCTURE OF INCOME DISTRIBUTION BY DECILE, 2009
(Percentages and number of times)



Source: ECLAC

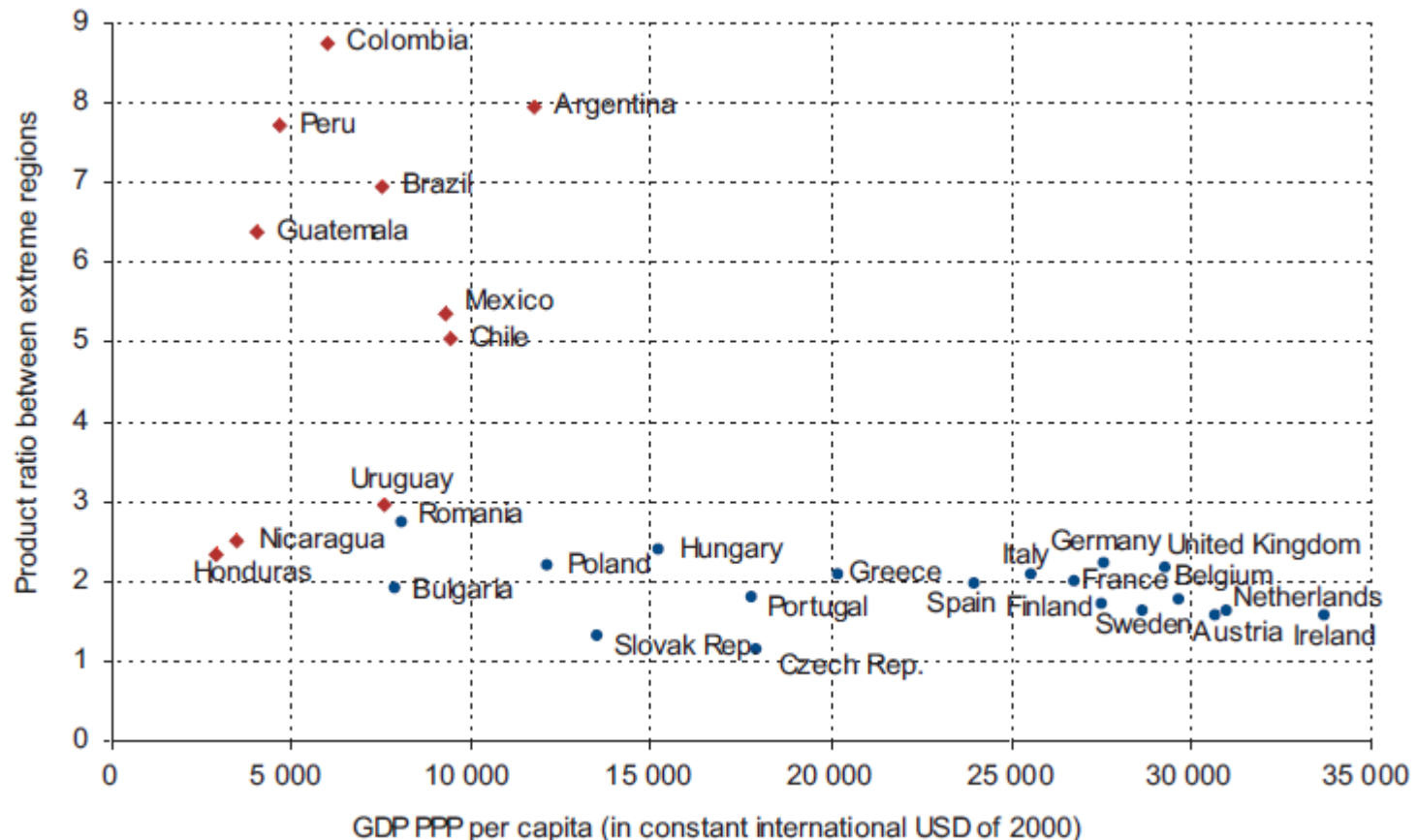
Note: Nicaragua, 2005; Honduras and Bolivia (Plur. State of) 2007; and Mexico and Venezuela 2008.

Main characteristics of Latin American inequality

- High Concentration
- **Geographical inequality**

There are high income gaps between regions within the same country.

LATIN AMERICA AND EUROPE (SELECTED COUNTRIES): RATIO OF HIGHEST TO LOWEST PER CAPITA GDP WITHIN THE SAME GEOGRAPHICAL AREA

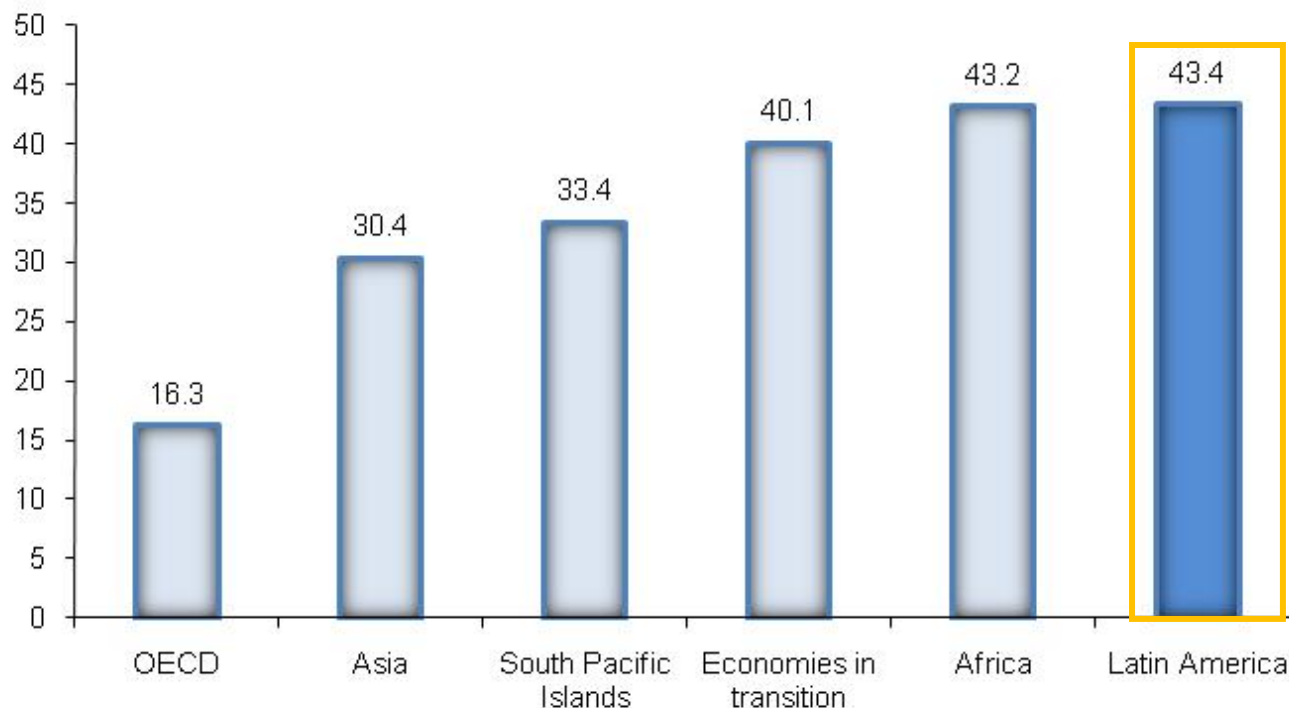


Main characteristics of Latin American inequality

- High Concentration
- Geographical Inequality
- **Prominent Levels of Poverty and Informality**

Latin America has the highest level of informal economic activity in the world

THE WORLD: THE INFORMAL SECTOR, AVERAGES FOR 2002-2003
(Percentages)



Source: ECLAC on the basis of Schneider (2006) "Shadow Economies of 145 Countries all over the World: What do we really know?", Department of Economics, Johannes Kepler University of Linz, Austria.

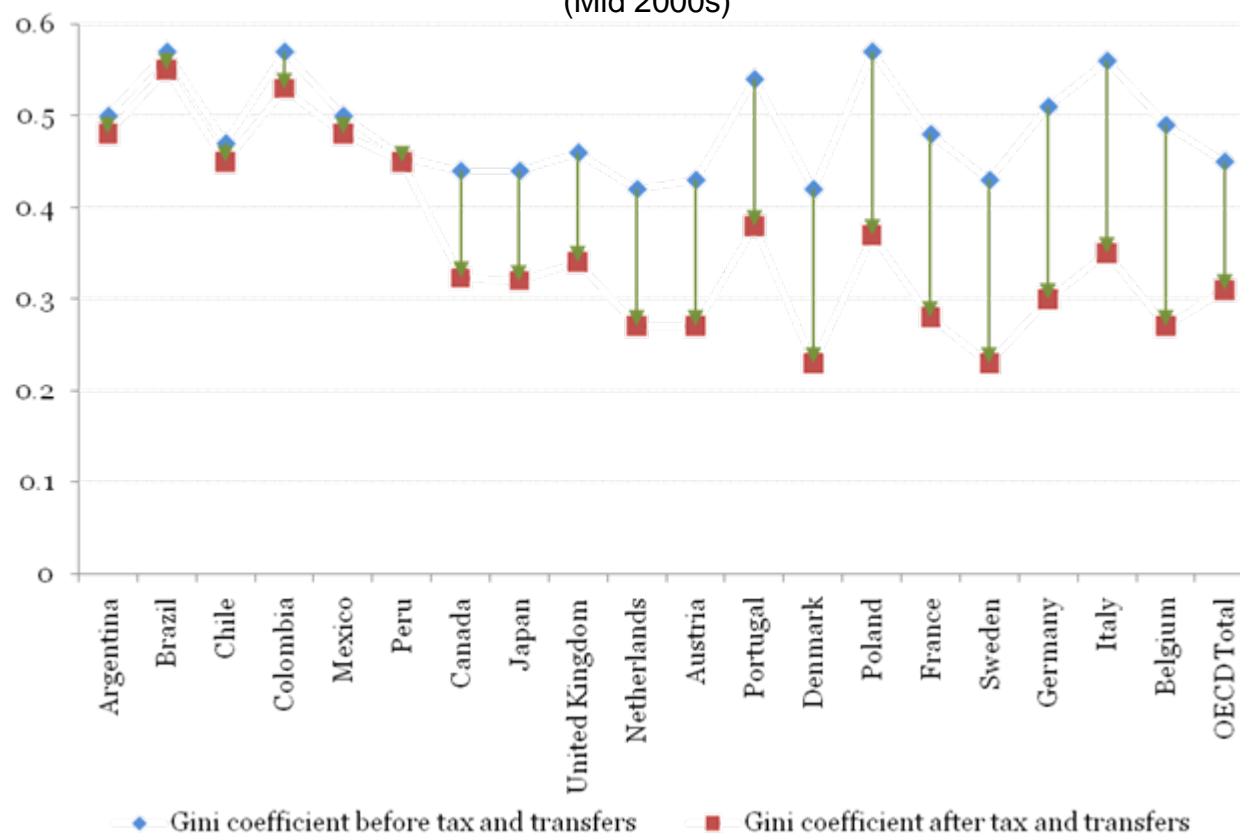
The role of tax policy in the distribution of income

Tax policy can impact equality in two ways:

- By financing public spending, it can contribute to the formation of human capital and improve market income.
- Through progressive taxes, it can modify the distribution of income after taxes. Income and property taxes, play a key role in this regard.

Fiscal policy in Latin America is not performing its redistributive function properly

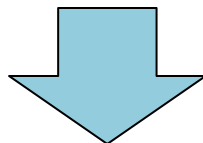
LATIN AMERICA AND OECD (SELECTED COUNTRIES):
GINI COEFFICIENTS OF MARKET AND DISPOSABLE INCOME
(Mid 2000s)



What bounds the redistributive role of tax policy in Latin America?

■ **Low and volatile tax burden**

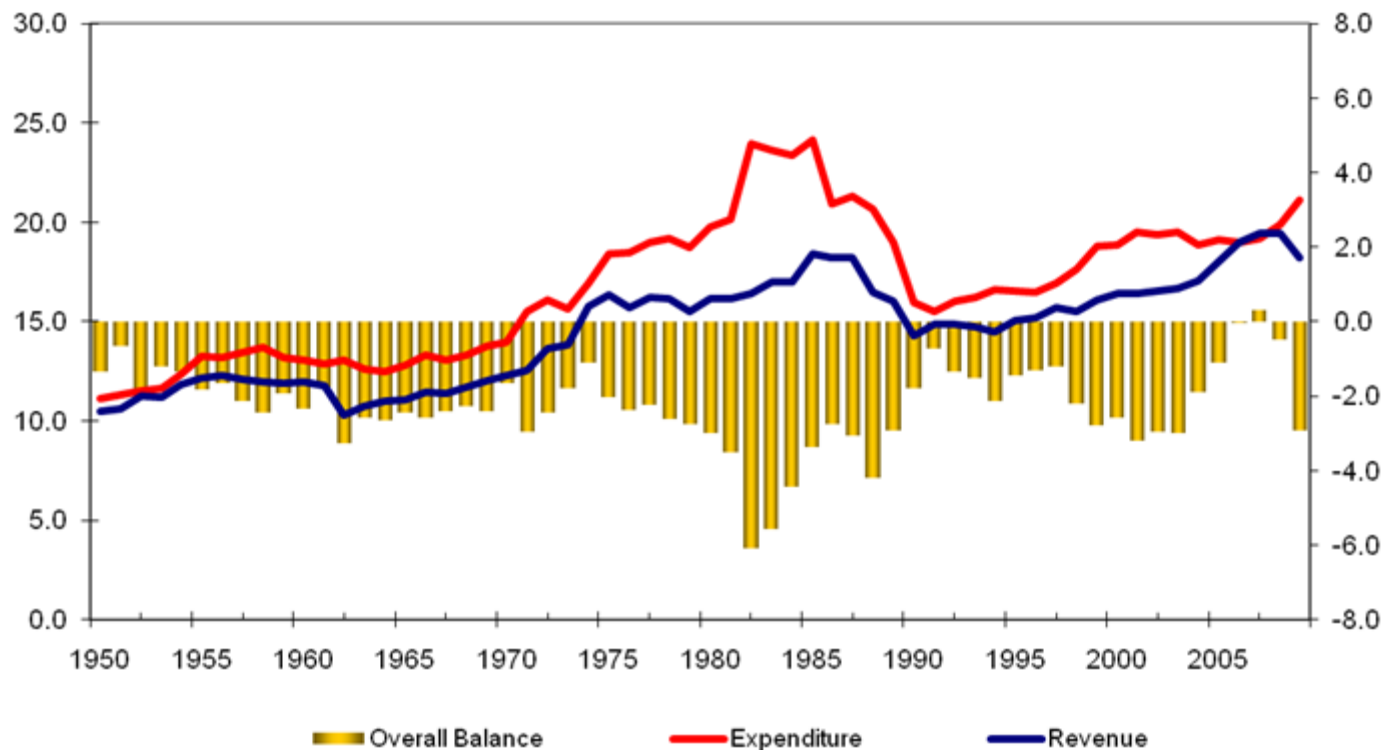
The region's potential tax burden is significantly higher than its effective one.



Resources for social spending
could be increased.

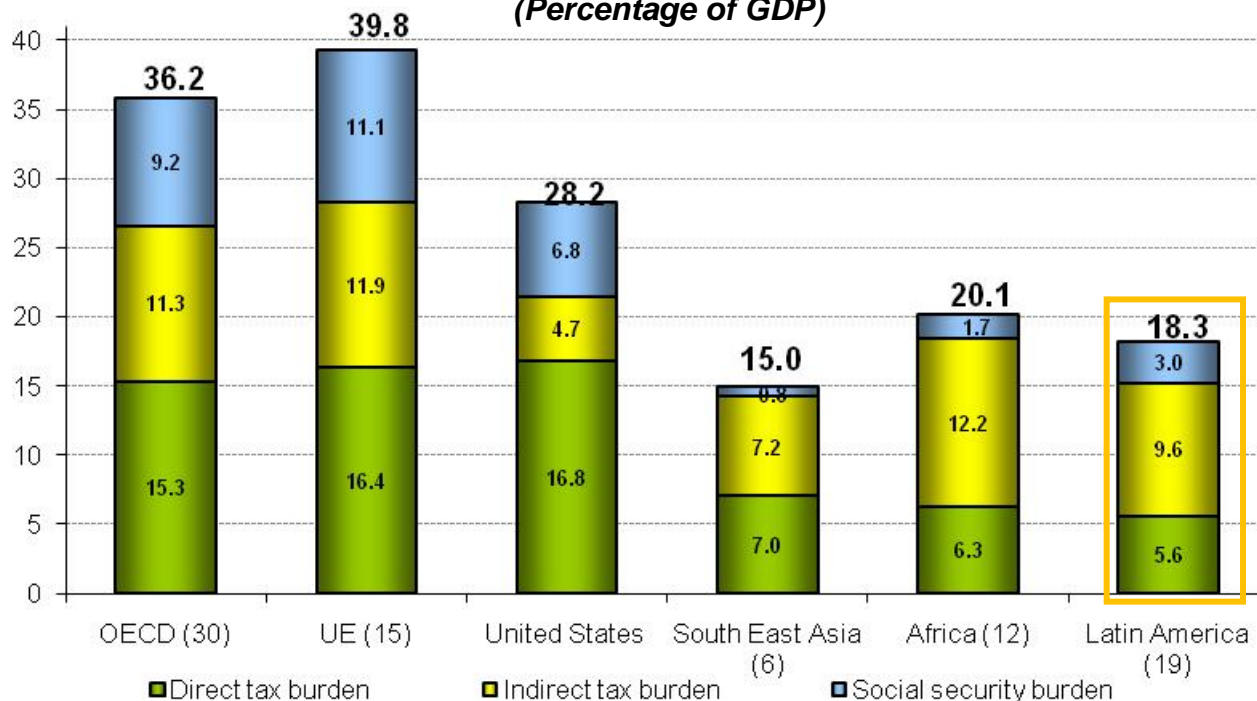
Historically, tax burden in Latin America has been low despite high government financing needs

**LATIN AMERICA AND THE CARIBBEAN: CENTRAL GOVERNMENT
INCOME, EXPENDITURES AND FISCAL BALANCE**
(Percentage of GDP, simple average)



Average tax burden in Latin America is half than that of the OECD

LATIN AMERICA AND THE REST OF THE WORLD:
INTERNATIONAL COMPARISON OF THE LEVEL AND STRUCTURE OF THE TAX BURDEN
(Percentage of GDP)

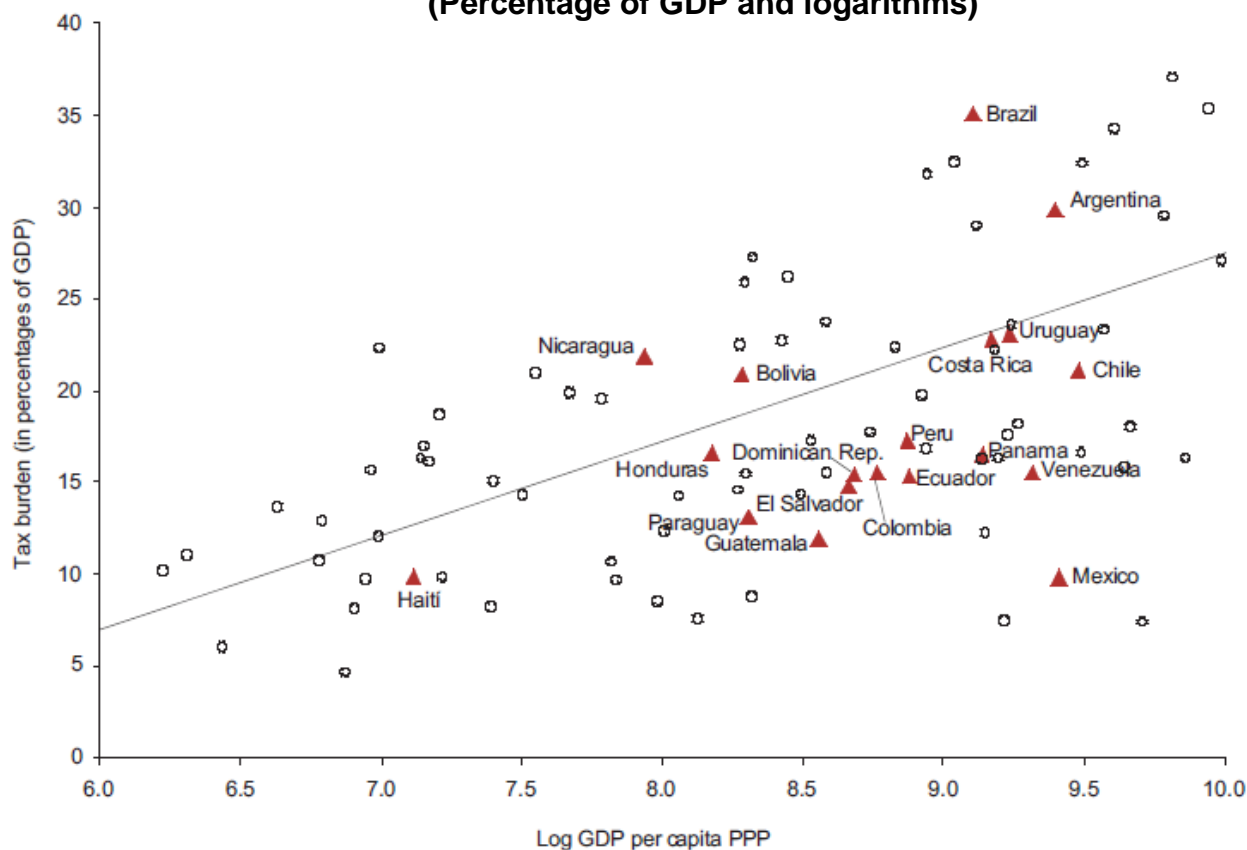


Source: ECLAC, OECD, and IMF

The region's low tax burden is primarily a result of low direct tax collection (income and property taxes).

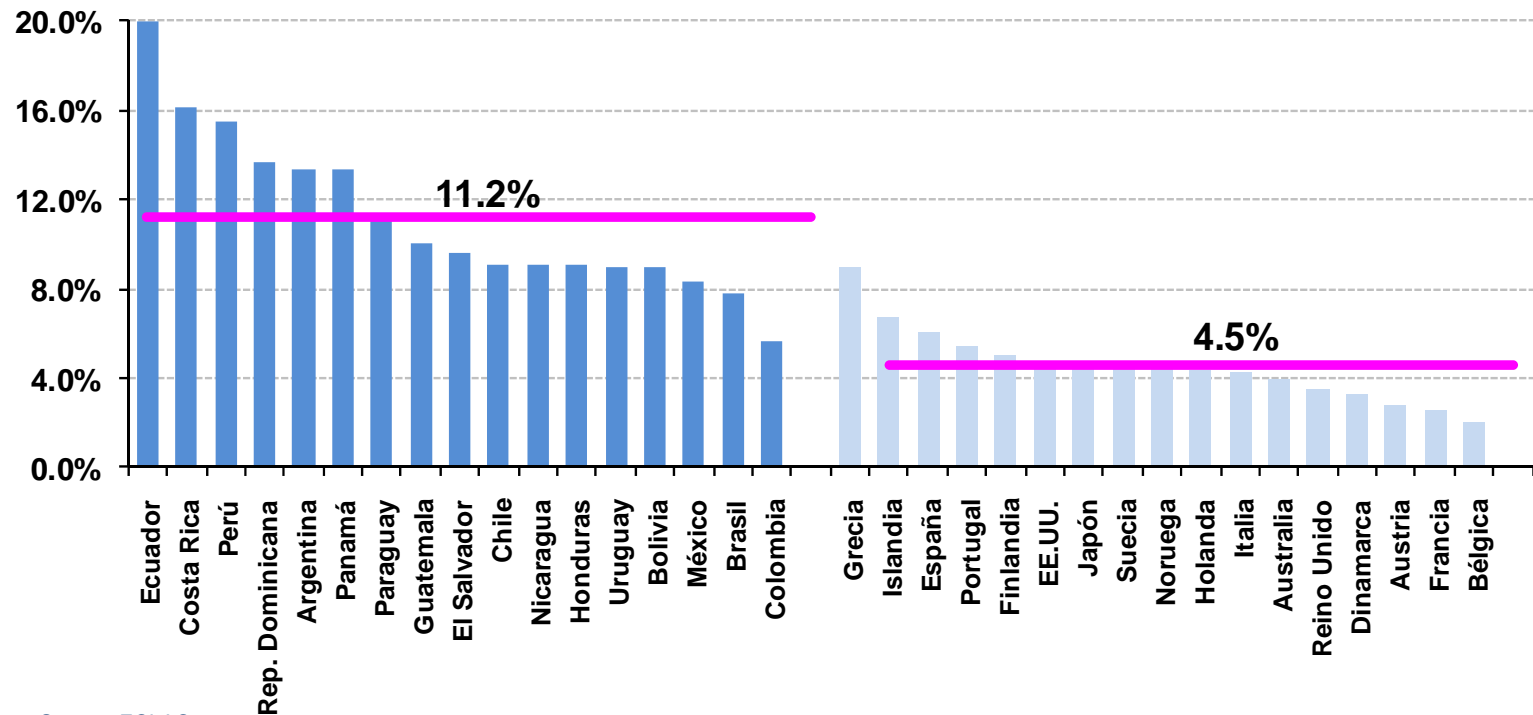
Tax burden in Latin American countries is undersized relative to their own level of development

**LATIN AMERICA AND THE WORLD (121 SELECTED COUNTRIES): COMPARISON OF TAX BURDEN AND PER CAPITA GDP IN PURCHASING POWER PARITY
(Percentage of GDP and logarithms)**



In addition, macroeconomic volatility causes a greater volatility in tax income

**LATIN AMERICA AND EUROPE (SELECTED COUNTRIES):
VOLATILITY IN TAX INCOME, WITHOUT SOCIAL SECURITY, 1980-2008**
(Standard deviation of the growth of tax income, USD 2000)

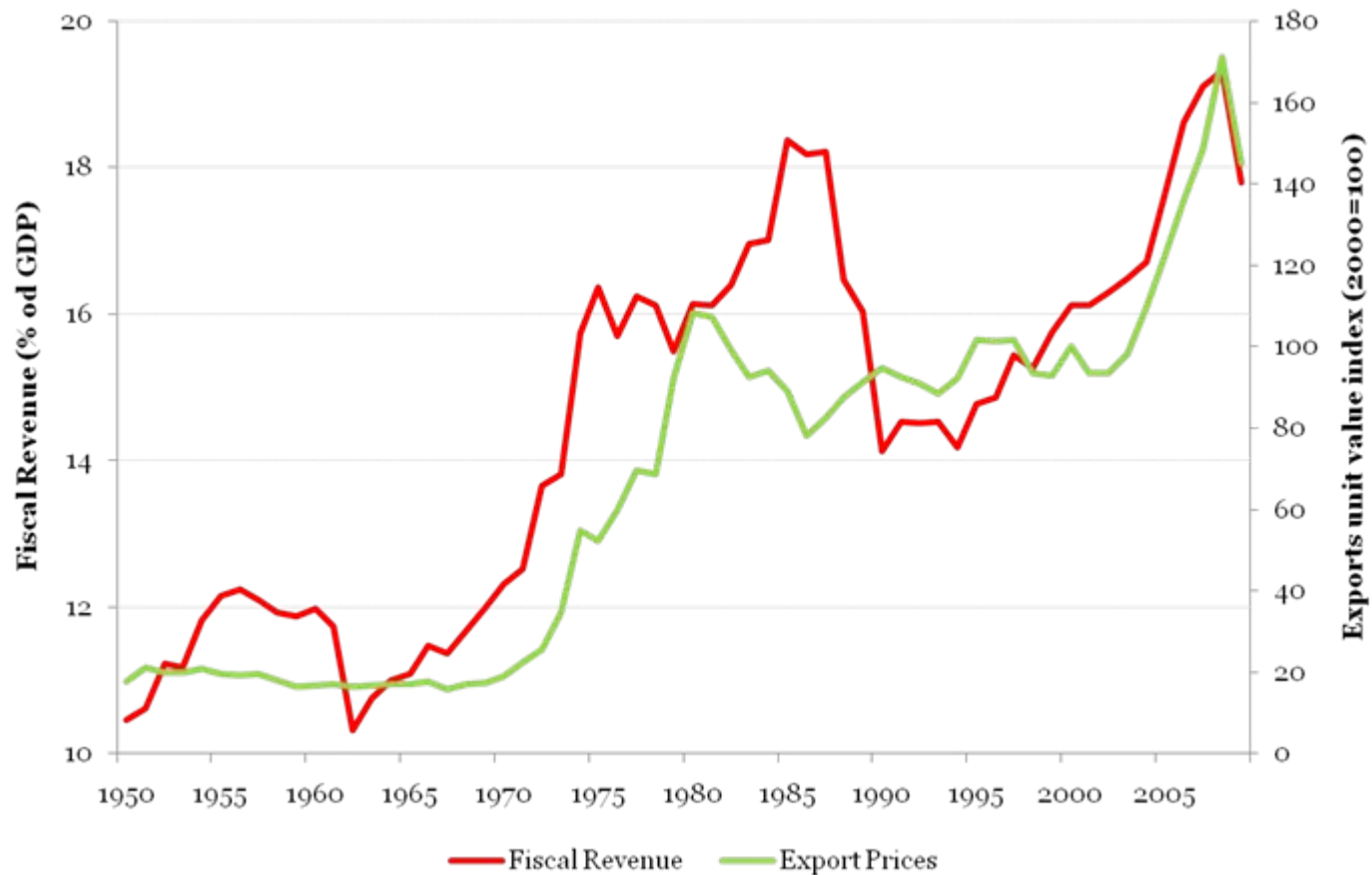


Source: ECLAC

This increases government financing needs and limits its capacity to invest in social programs.

High correlation between fiscal revenues and export prices

Latin America: Fiscal Revenues and Export Prices (1950-2009)



What bounds the redistributive role of tax policy in Latin America?

- Low and volatile tax burden

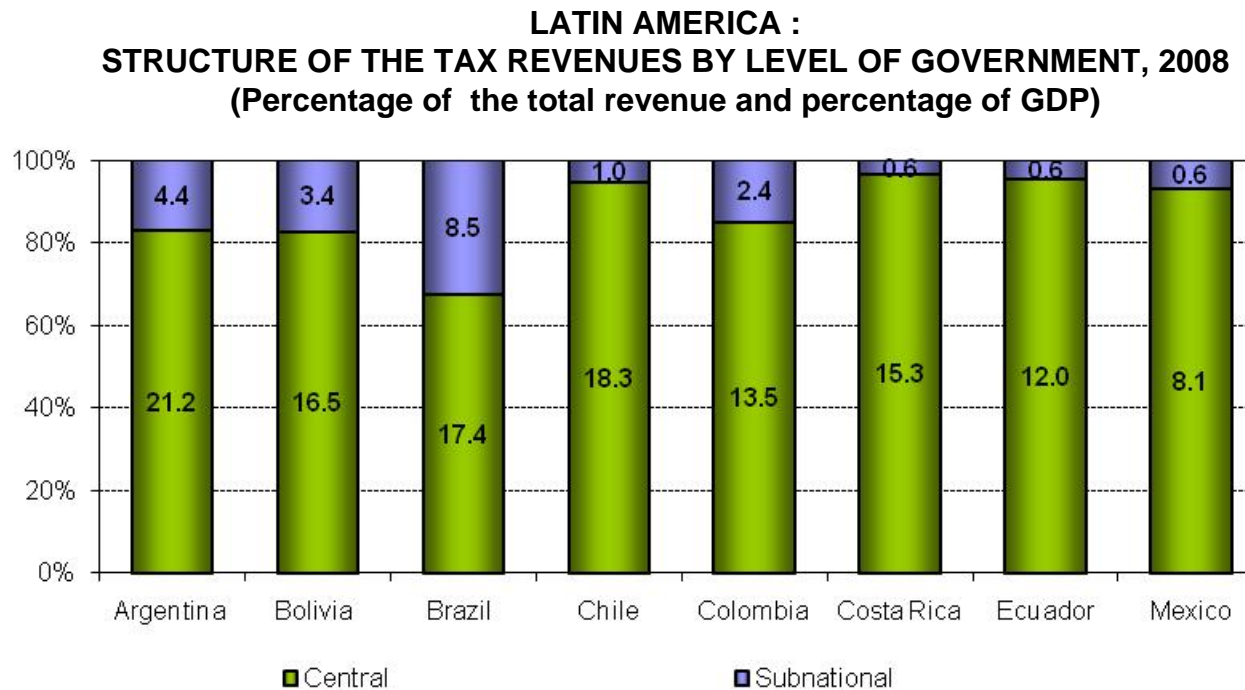
- **Regressive tax structure**

The main cause of the gap between potential and effective revenue is a shortfall in direct taxation, specifically, in personal income tax.

Tax structures in Latin America are characterized by:

- Low income tax revenues.
 - Focused on corporations.
- Personal income tax is mainly a tax on income from waged employment.
- Insignificant property taxes.
- Preeminence in general taxes on consumption (VAT-type taxes).
 - It is government's primary source of revenue.
- High importance of fiscal revenues originated in NNRR.

Strengthening of property taxes is a challenge, particularly for subnational governments



Source: ECLAC

Property taxes should be strengthened at the subnational level. In order to do it cadastral records should be improved.

Low compliance and high evasion level undermine the stability and legitimacy of tax systems

- Neither the level of revenue nor the tax structure is sustainable with a poor degree of compliance.
 - Tax evasion and avoidance limits resources for social spending.
 - These practices are among the principal causes of inequity. They violate both:
 - Horizontal equity: people with a similar ability to pay taxes do not pay the same or similar amounts
 - Vertical equity: people with a greater ability to pay taxes do not pay more

Conclusions and future challenges

- In Latin America taxation has not been a good distributive policy tool.
- The region's potential tax burden is significantly higher than its effective one.
- Tax structure in Latin-American countries is skewed toward indirect taxation.
- There is a shortfall in direct taxation, specifically, in personal income tax.
- In several countries, the importance of NNRR tax base has weakened the tax system

Conclusions and future challenges

- All these characteristics have weakened the multiple dimensions of equity
- The challenge: there is some role for fiscal policy in general and tax policy in particular to improve?...
 - Vertical equity
 - Horizontal equity
 - Regional equity
 - Intergenerational equity

Thank you!

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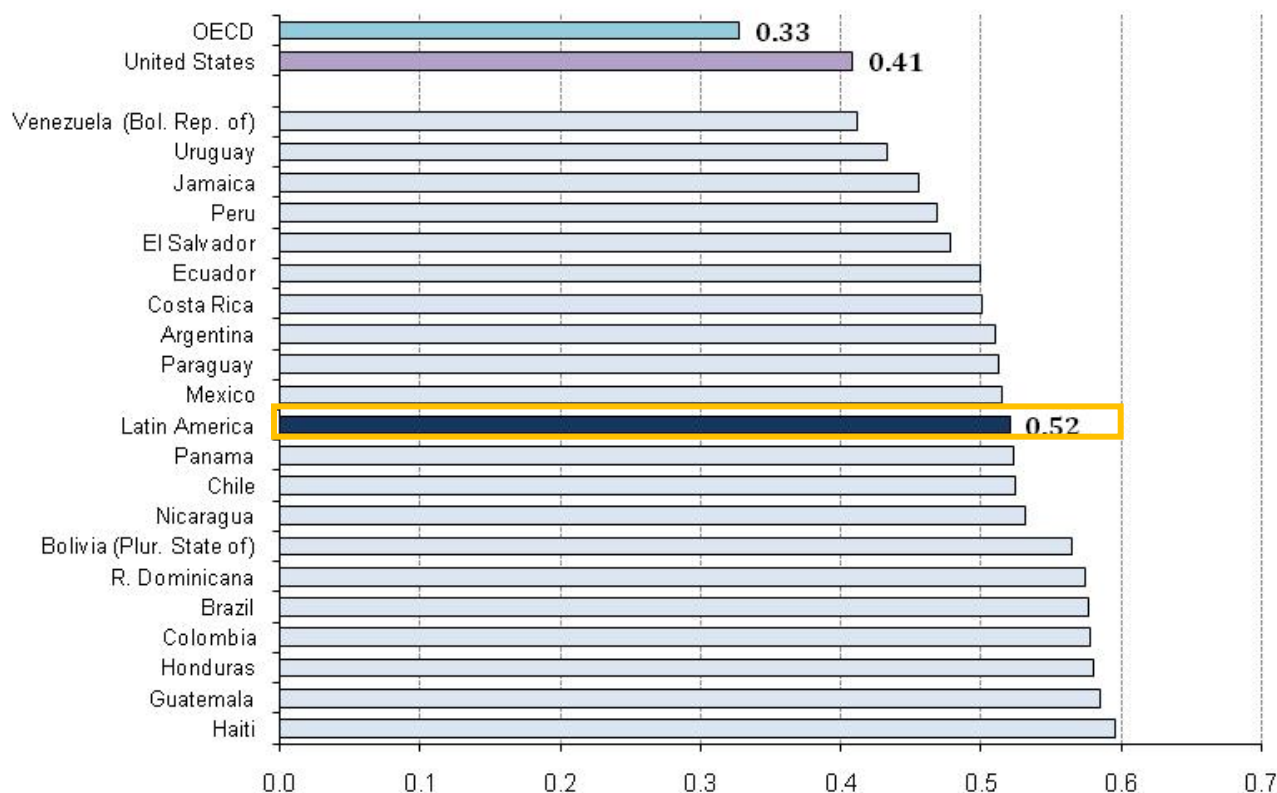
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May 24 2011, Washington D.C.

E C L A C

Cronic inequality: most countries have Gini indices above 0.5

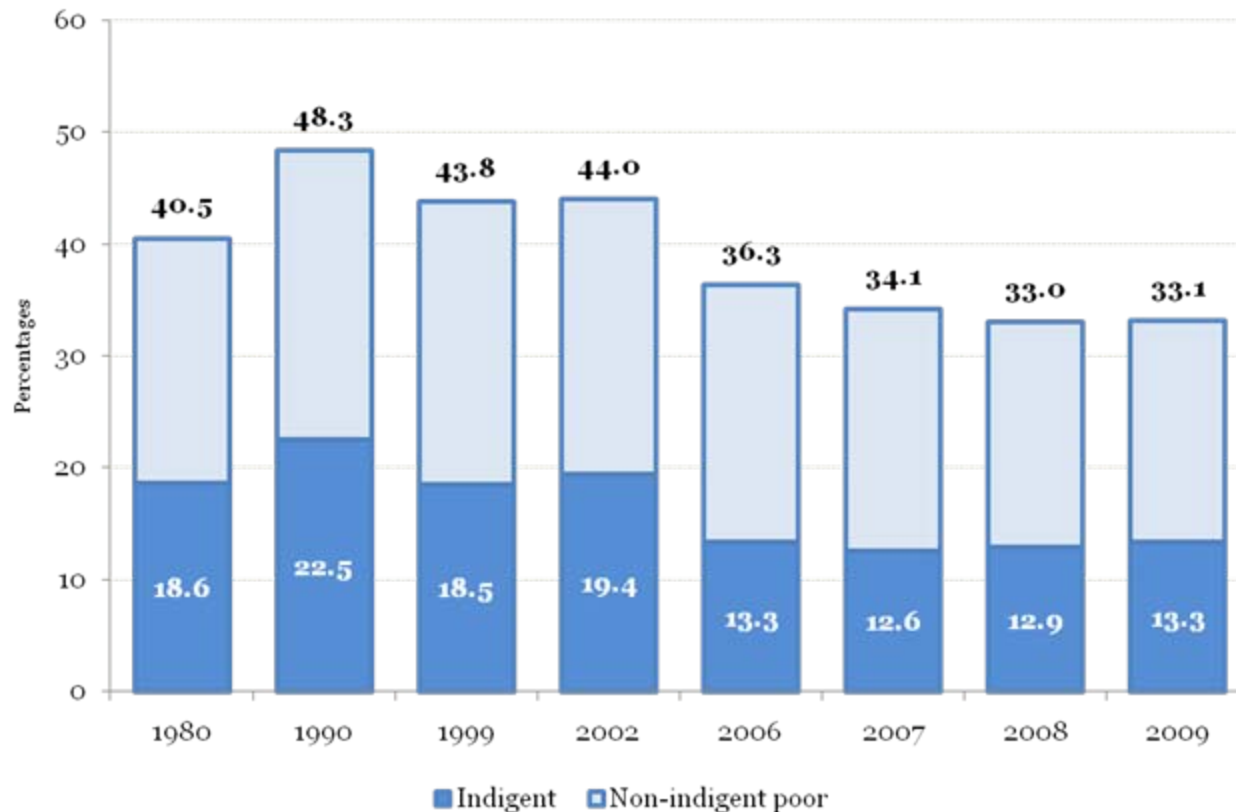
LATIN AMERICA AND THE CARIBBEAN, OECD AND THE UNITED STATES:
GINI INEQUALITY INDICES
(circa 2009)



Source: ECLAC OECD and The World Bank
Note: Chile and Mexico are not included in OECD calculations

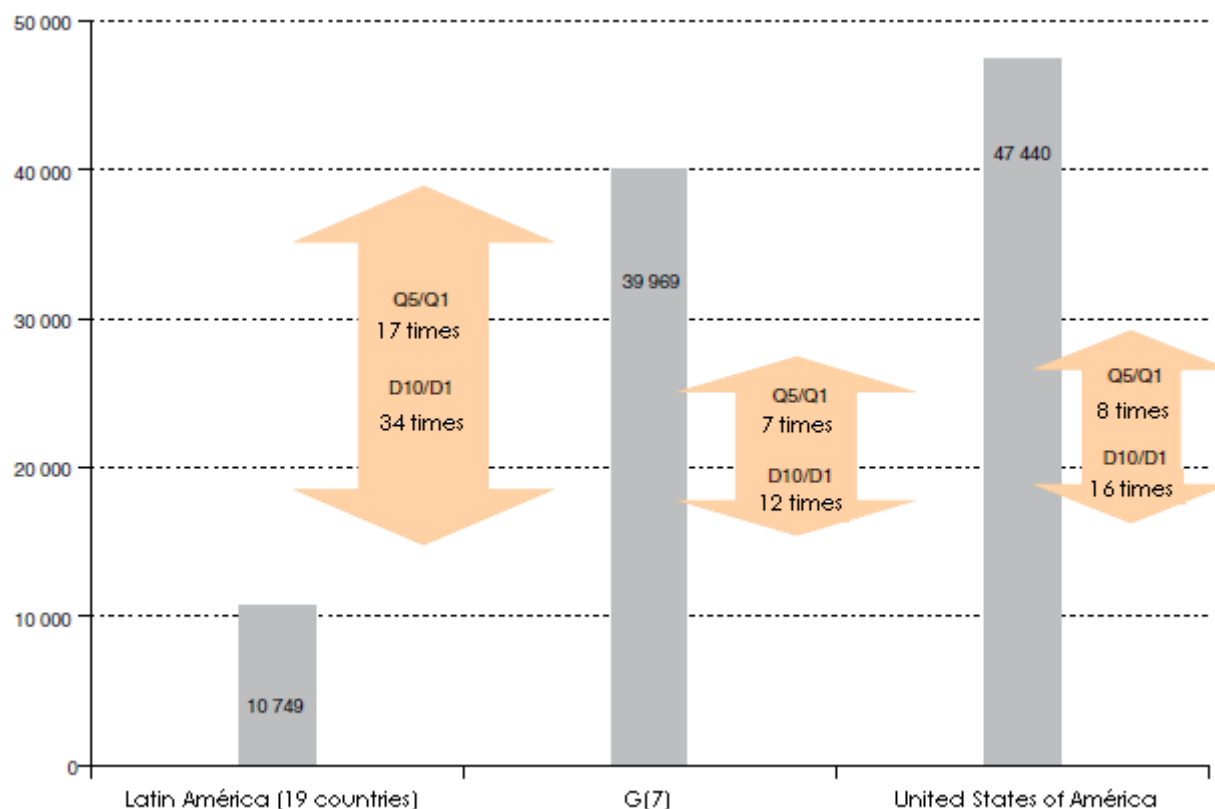
The wealthy few coexist with a vast majority living below subsistence levels

LATIN AMERICA: POVERTY AND INDIGENCE 1980-2009
(Percentages)



Latin America has been singled out due to its high income inequality

LATIN AMERICA AND DEVELOPPED COUNTRIES: PIB PER CAPITA AND INCOME DISTRIBUTION
(PPP USD, 2008)

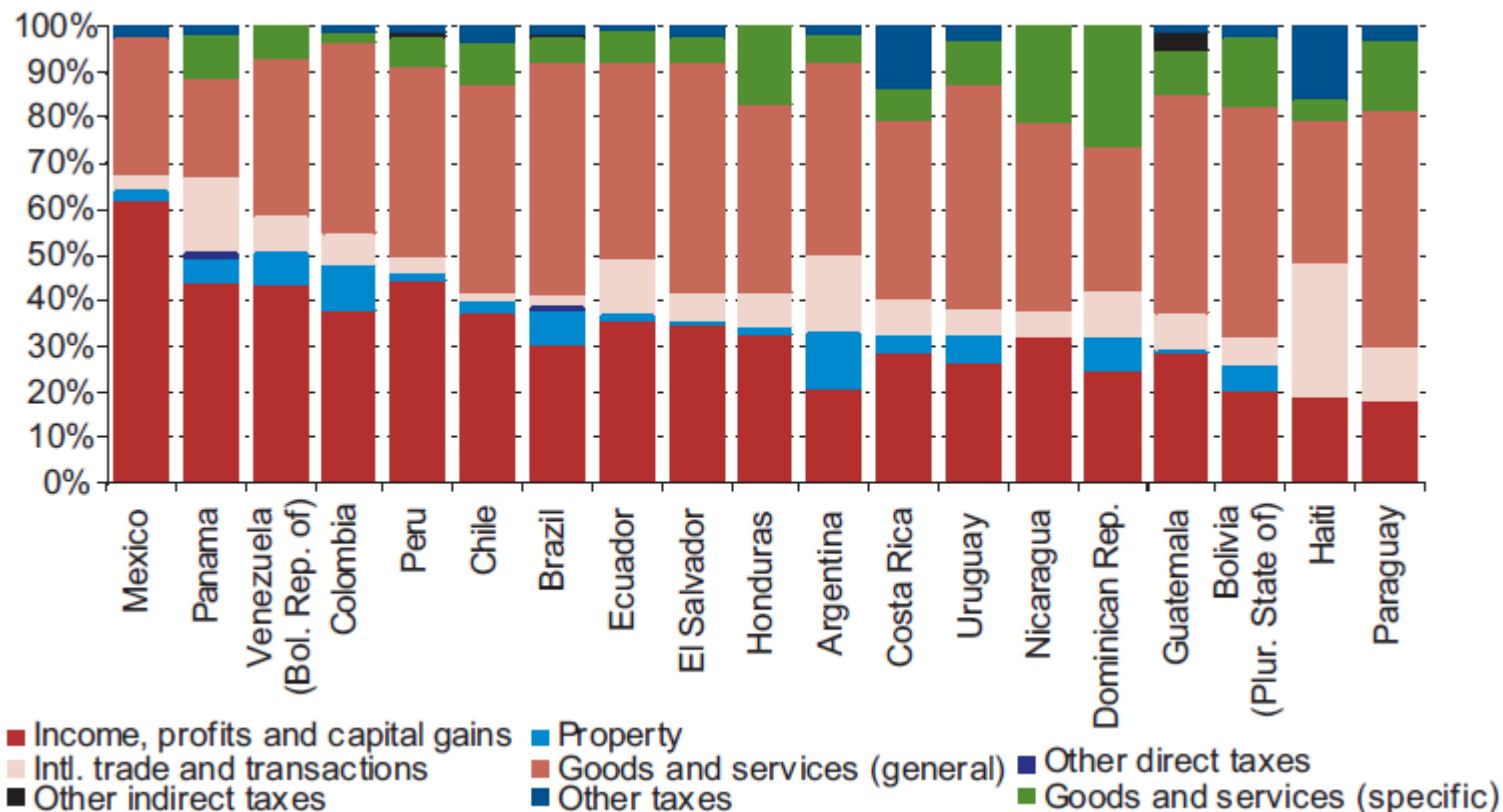


Source: ECLAC

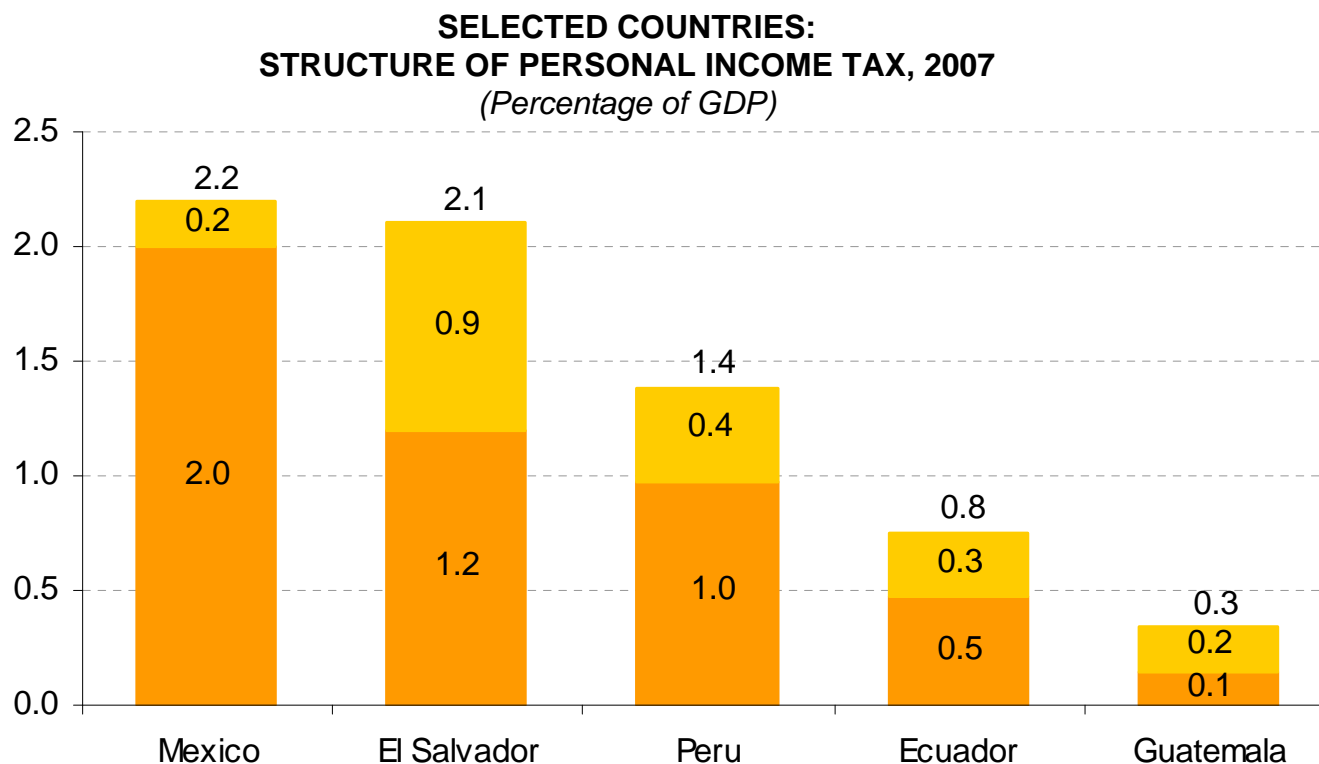
Note: Q5/Q1 (D10/D1) represents the ratio between the extreme quintile (decile) of the distribution.

Tax structure is heavily skewed towards indirect taxation

LATIN AMERICA AND THE CARIBBEAN: TAX STRUCTURE BY COUNTRY, 2008
(Excluding Social Contributions)



Personal income tax is mainly a tax on income from waged employment



Source: ECLAC

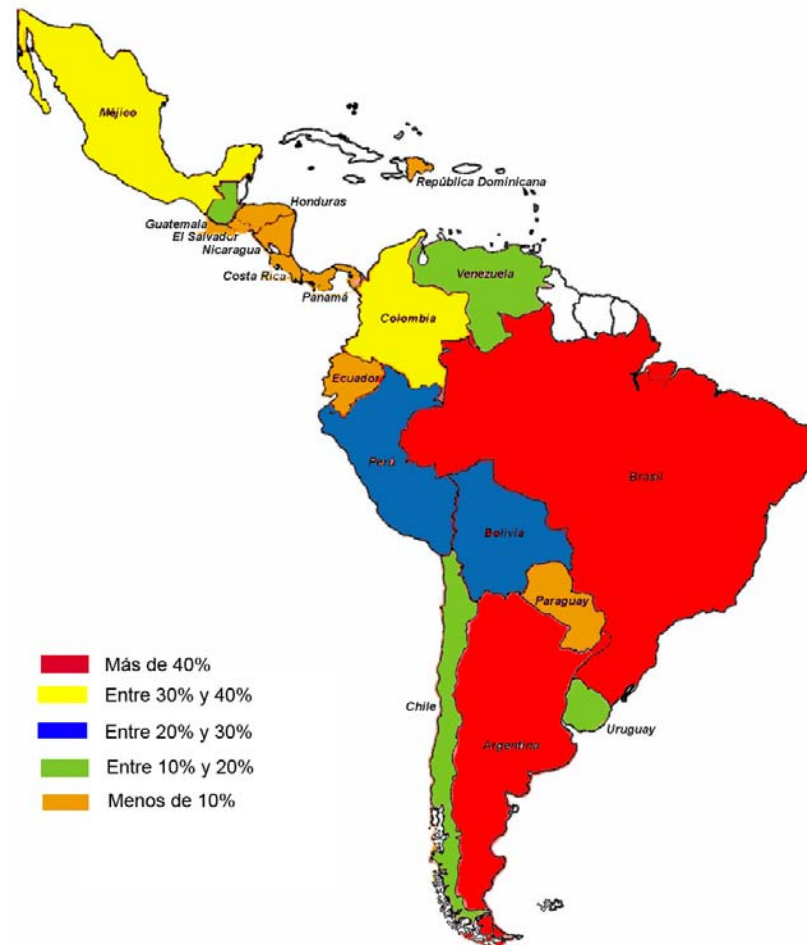
■ Wage labor

■ Other personal income

Personal income tax gap is larger in the case of non-wage income, which escapes from authority regulation.

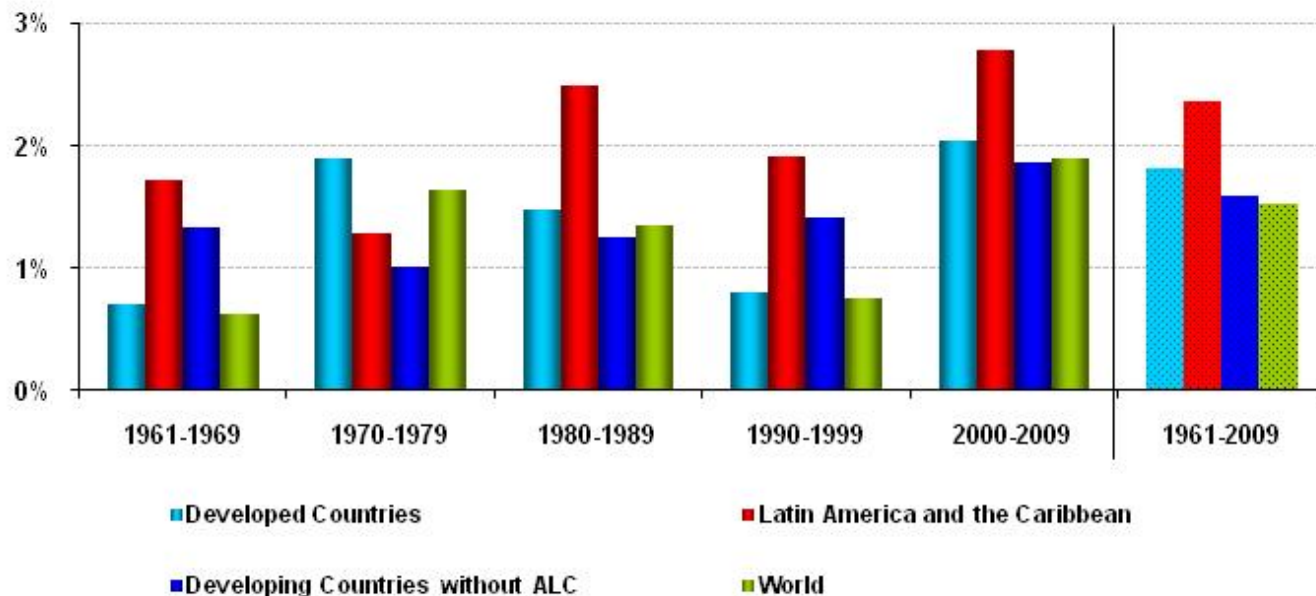
The most decentralized countries have a political federal system and are among the most extensive.

LATIN AMERICA : PERCENTAGE OF PUBLIC EXPENDITURE FROM THE SUBNATIONAL GOVERNMENTS



Thus, governments in Latin America do not necessarily provide a buffer against adverse shocks.

THE WORLD: VOLATILITY OF PER CAPITA GDP GROWTH
(Percentages)

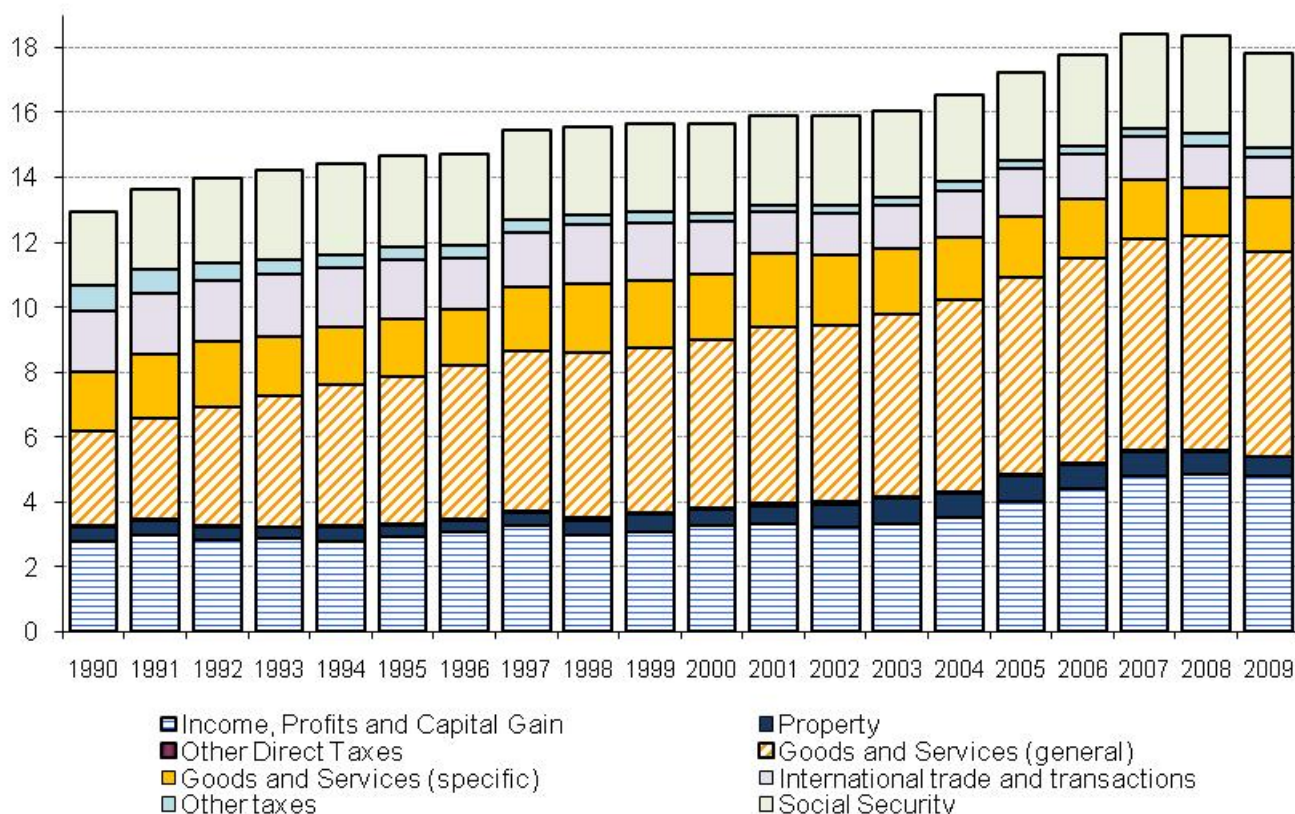


Source: Kacef and Jimenez (2010), based on database from ECLAC

The high degree of economic volatility is closely related to external shocks, such as reversals in capital flows or terms of trade.

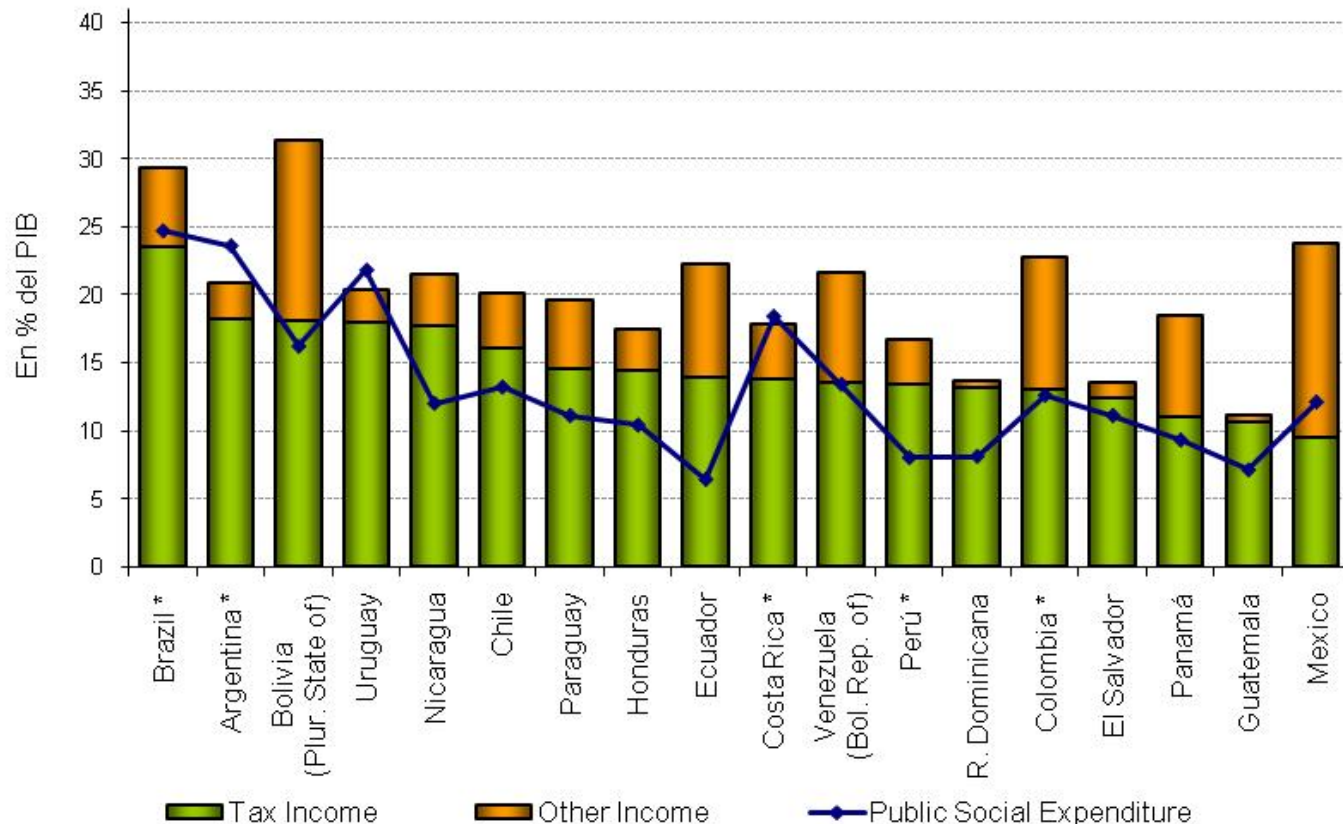
Tax structure is heavily skewed towards indirect taxation

LATIN AMERICA AND THE CARIBBEAN: TAX STRUCTURE, 1990-2009
(Percentage of GDP – Simple Average)



Increased tax burden may improve equality through a higher level of tax revenues invested in social programs

**LATIN AMERICA AND THE CARIBBEAN:
FISCAL REVENUE AND PUBLIC SOCIAL EXPENDITURE BY COUNTRY, 2009
(Percentage of GDP)**

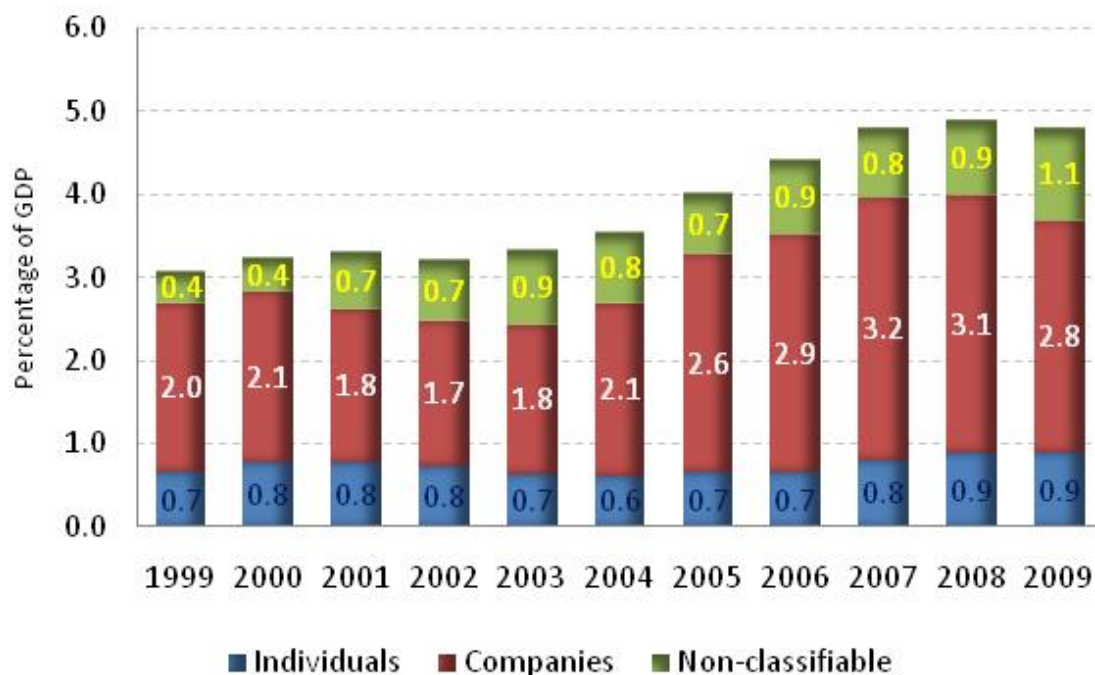


Source: ECLAC.

Note: (*) In these countries government coverage is broader because it incorporates public companies.

Income tax revenue is primarily from income earned by corporations

LATIN AMERICA :
CORPORATE AND INDIVIDUAL INCOME TAX, 1998-2009
(Percentage of GDP)



Source: ECLAC.

Note: "Non classifiable" corresponds to data where official figures do not make a difference between persons and companies.

Mostly income from corporations engaged in the exploitation of non-renewable resources.

Why are direct taxes absent from the picture?

- Low median income & poor income distribution
- Prominent levels of informality
- Poor tax compliance
- The wide use of tax incentives
- Employee compensation accounts for a small share of GDP
- Tax policy design that favors economic neutrality and efficiency
- Weak tax authorities
- Political obstacles

Conclusions and future challenges

- Thus, direct taxation must be strengthened, specially, personal income tax base should be expanded.
- This requires:
 - Broadening the bases of direct taxes.
 - Limiting the use of tax incentives.
 - Curbing tax evasion and avoidance.
 - Strengthening property taxes, mainly at the subnational level.