

# The political viability of progressive tax reforms in Brazil

Presentation at the seminar Taxation and Equality in Latin America  
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# Puzzle

- The median vote theorem
- Democratization in Brazil and Latin America has been accompanied by an expansion of the tax burden via indirect taxation
  - $\Delta$  tax burden in 1990 a 2008 = 7,3 %GDP
    - Brazil = 9,1%
  - 2,5% gdp (34%) via direct taxation
  - 4,8 gdp (66%) via indirect taxation
    - Brazil = 72%

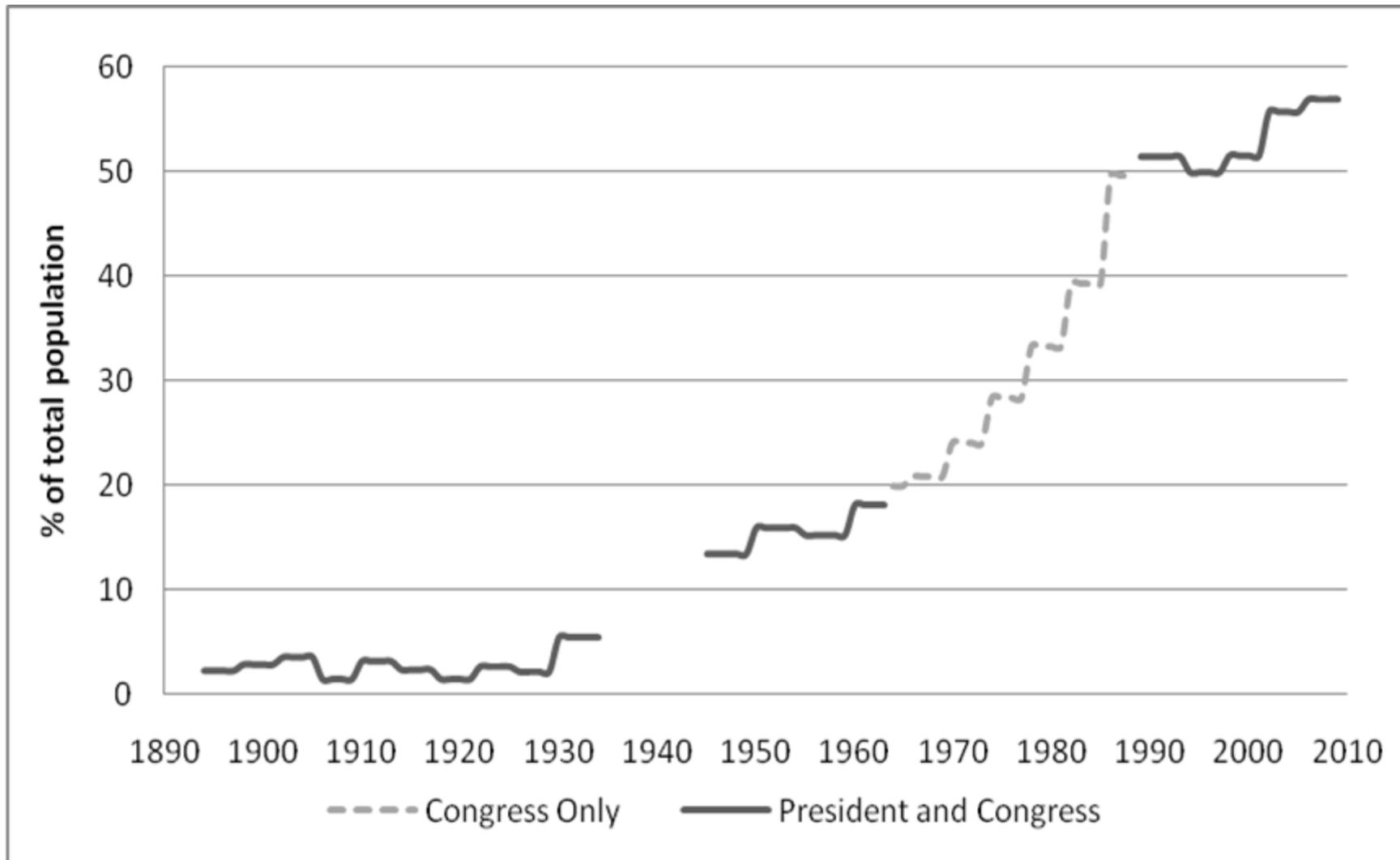
# Panel corrected estimate 1996-2008, LA

DV= increase in tax burden

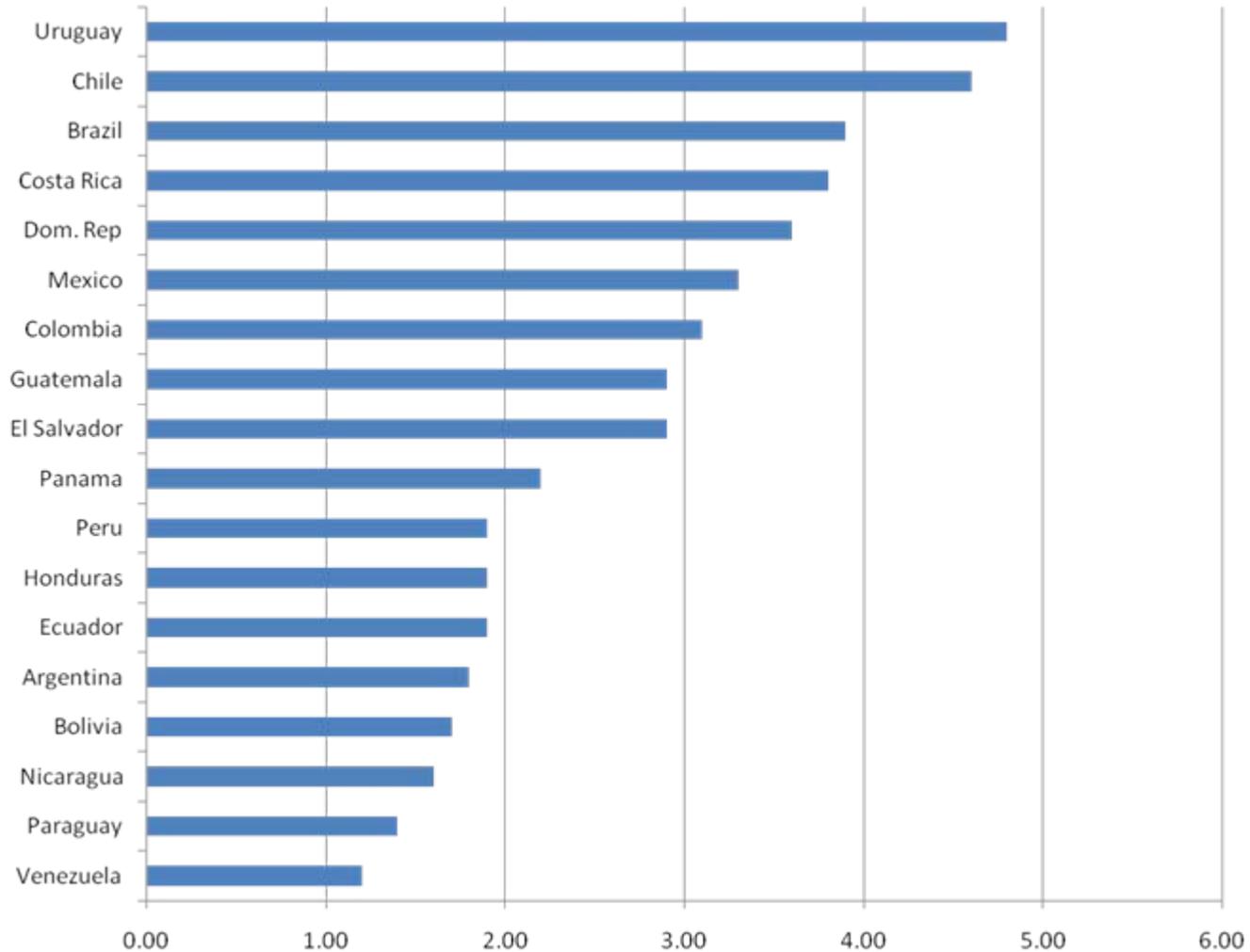
Cte	-46,12**(-2,2)
LogR	7,81*** (3,3)
Voice	2,91** (1,98)
Effectiveness	6,97** (2,04)
Pol. stability	0,91* (1,78)
Reg. quality	-1,34 (-1,04)
Rule of law	-1,14* (-1,65)
Cont. corruption	0,72 (1,04)
Índice de reforma	0,37 (0,76)
2005 a 2008	stat significant
Brasil	5,3*** (3,18)
Chile	5,34* (1,76)
Colômbia	4,12** (1,97)
Costa Rica	6,6*** (1,98)
R2	0,97
Nº Obs	180
F	130,48

# The median voter and mass democracy in Brazil

% of population voting for President and Congress 1894-2010

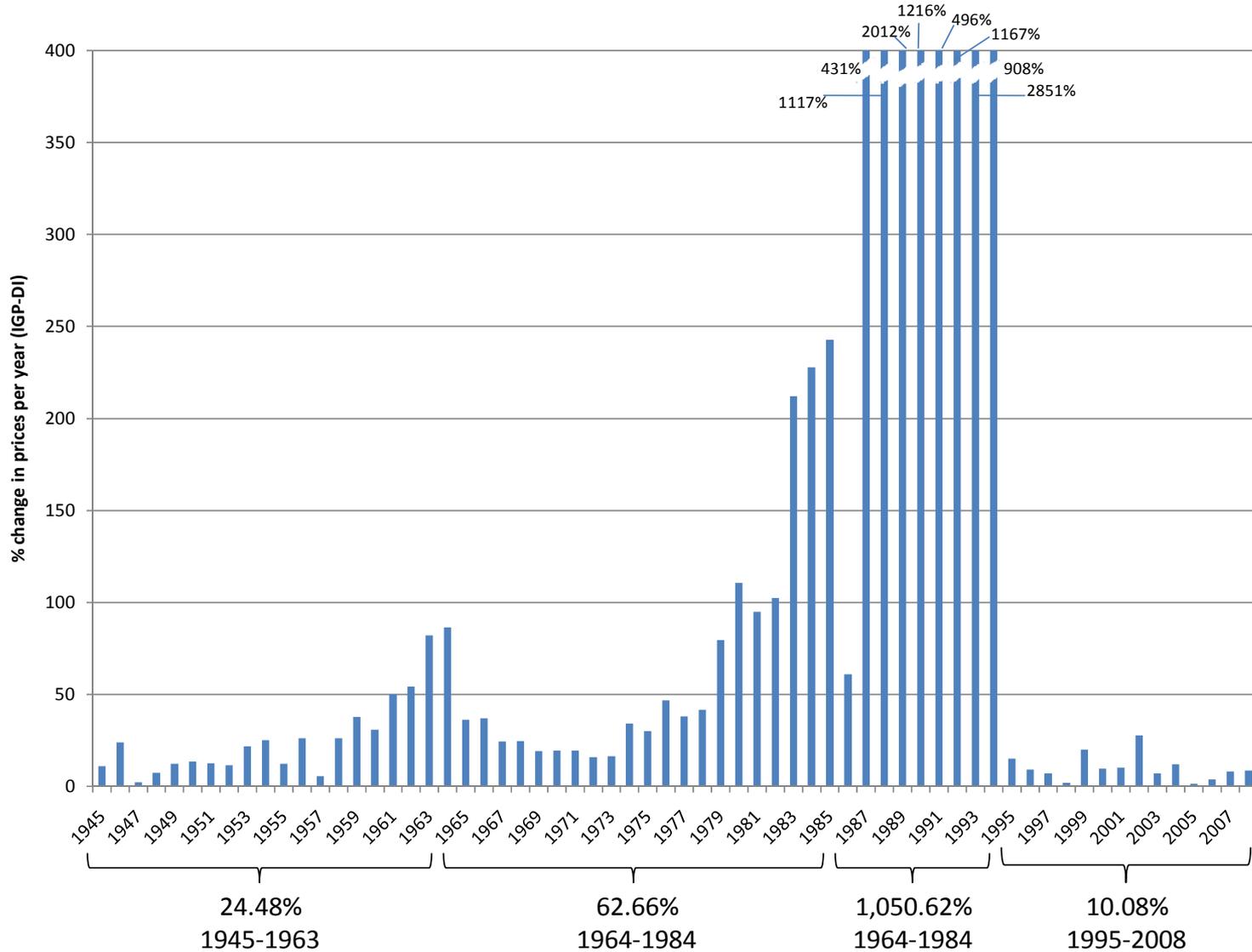


# Rule of Law and Judicial independence in Latin America

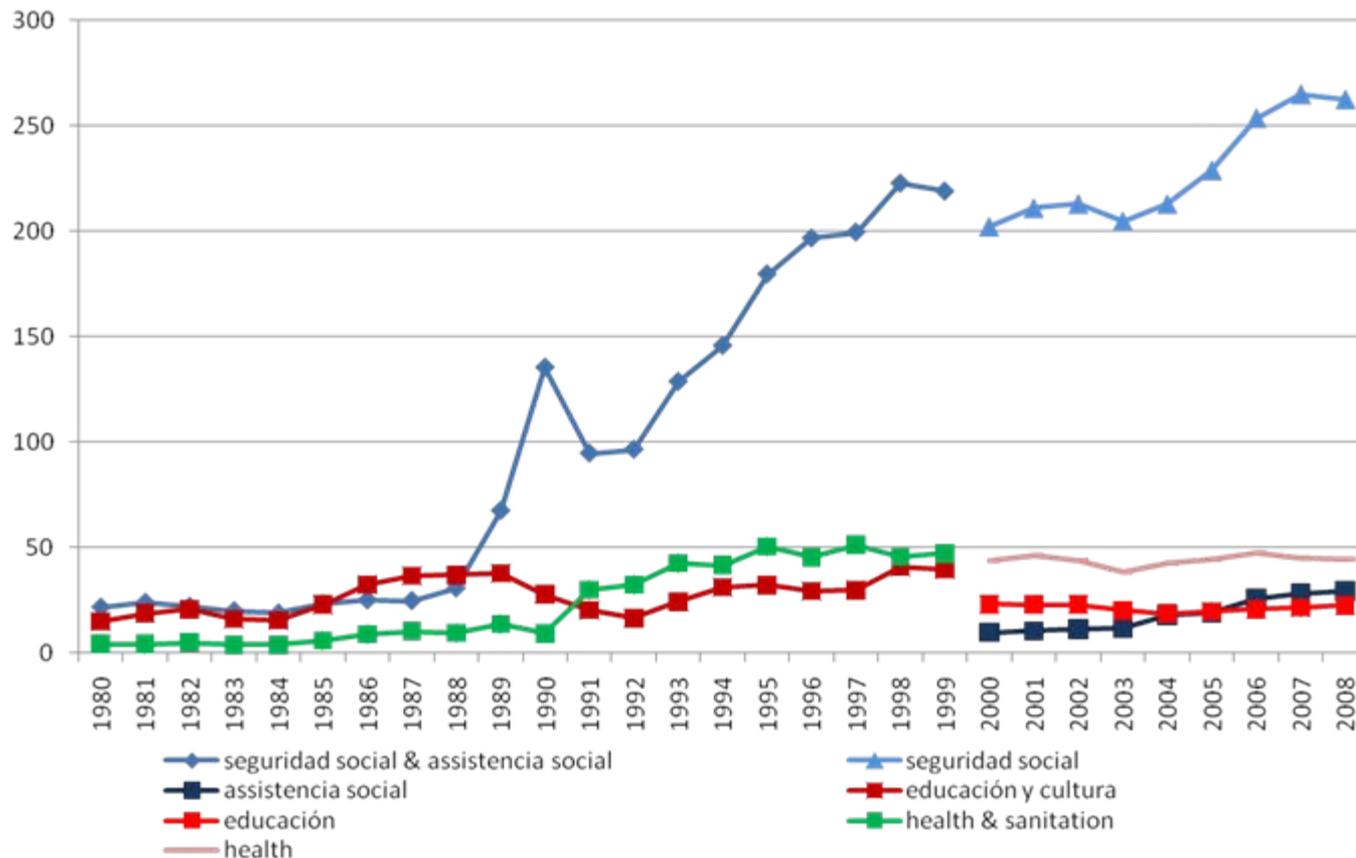


# The rise of entitlements

## The 1988 constitution and hyperinflation



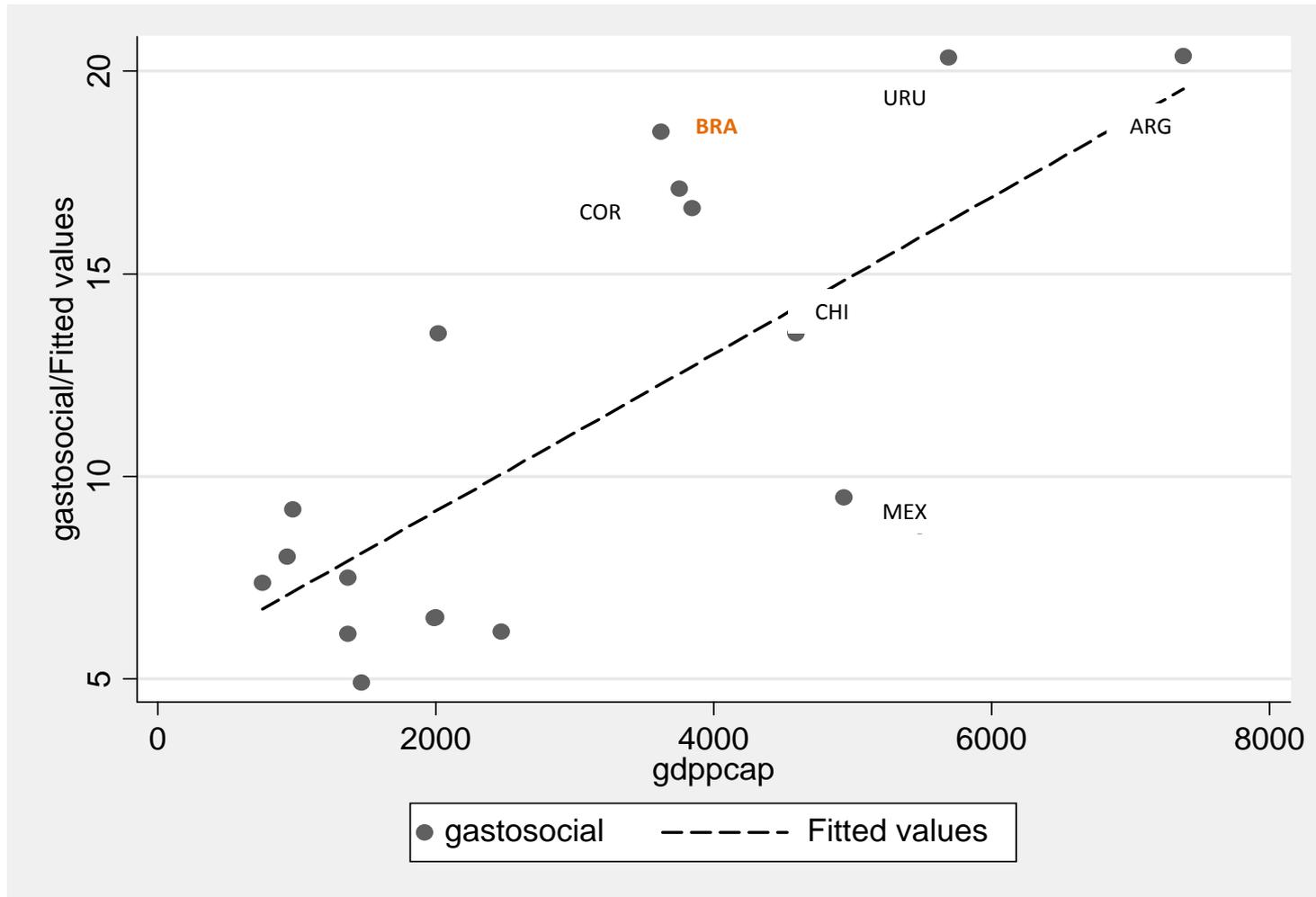
# Social expenditures by function 1980-2008



Source: SIAFI (STN/MF)

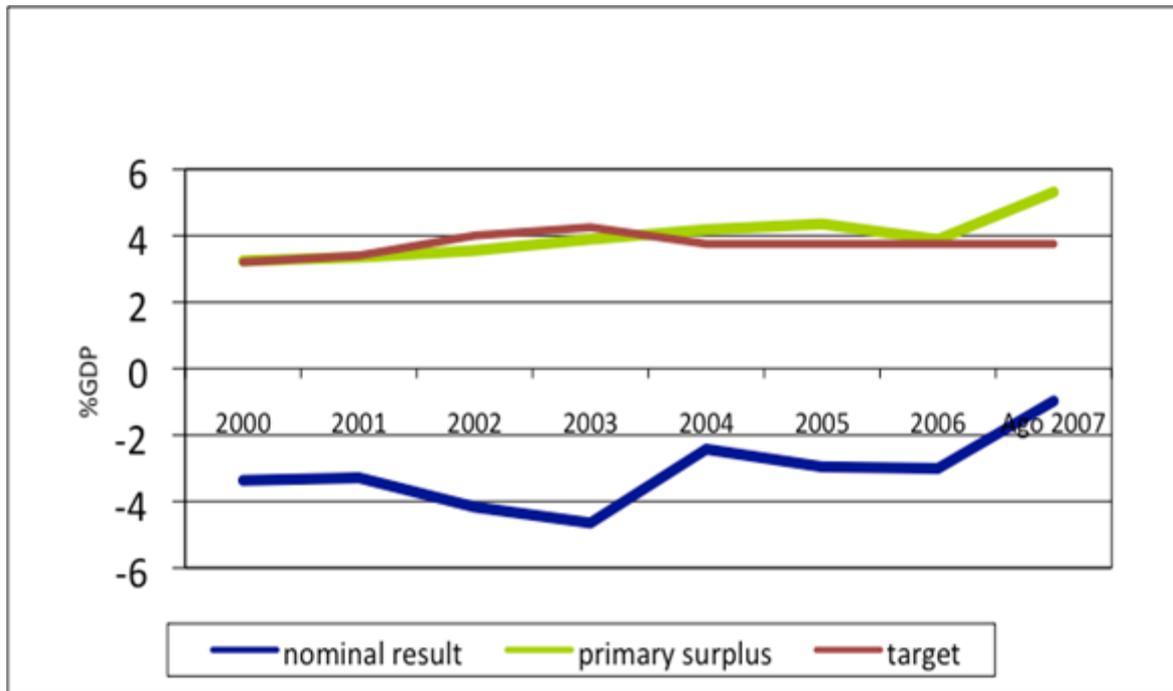
Deflated by IGP-DI, april/2009.

# Latin America – social spending as % of GDP (average 1990-2007)

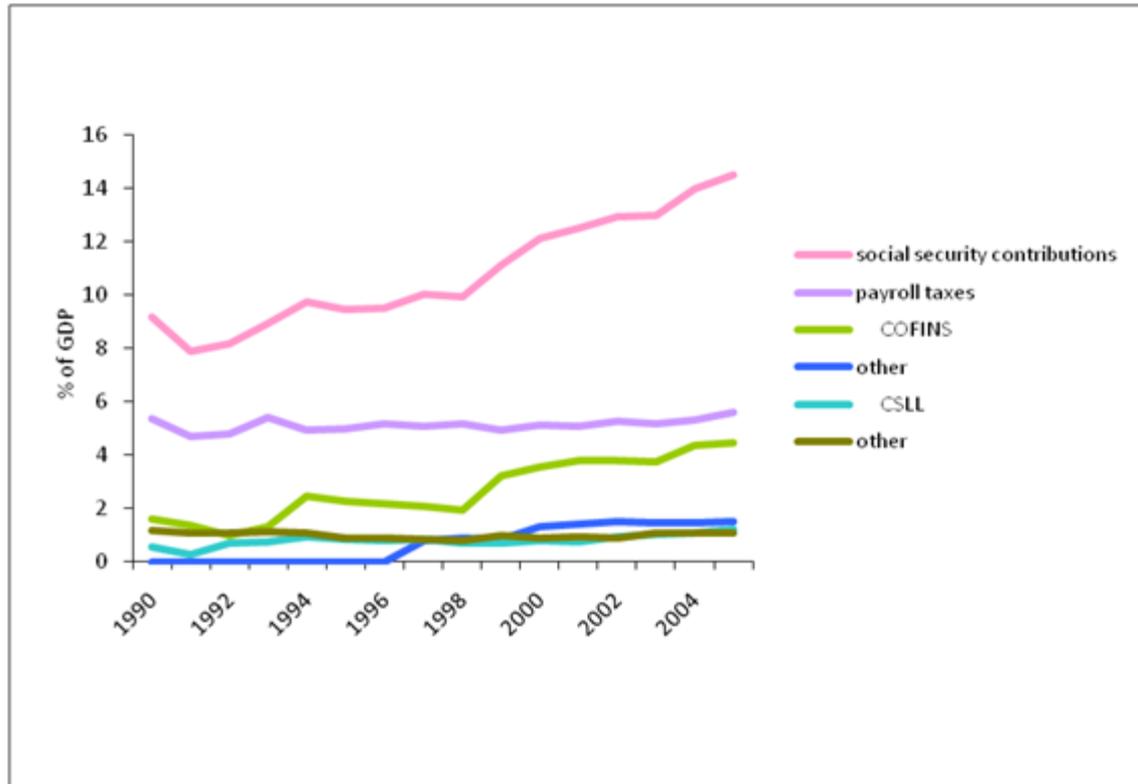


# The fiscal imperative

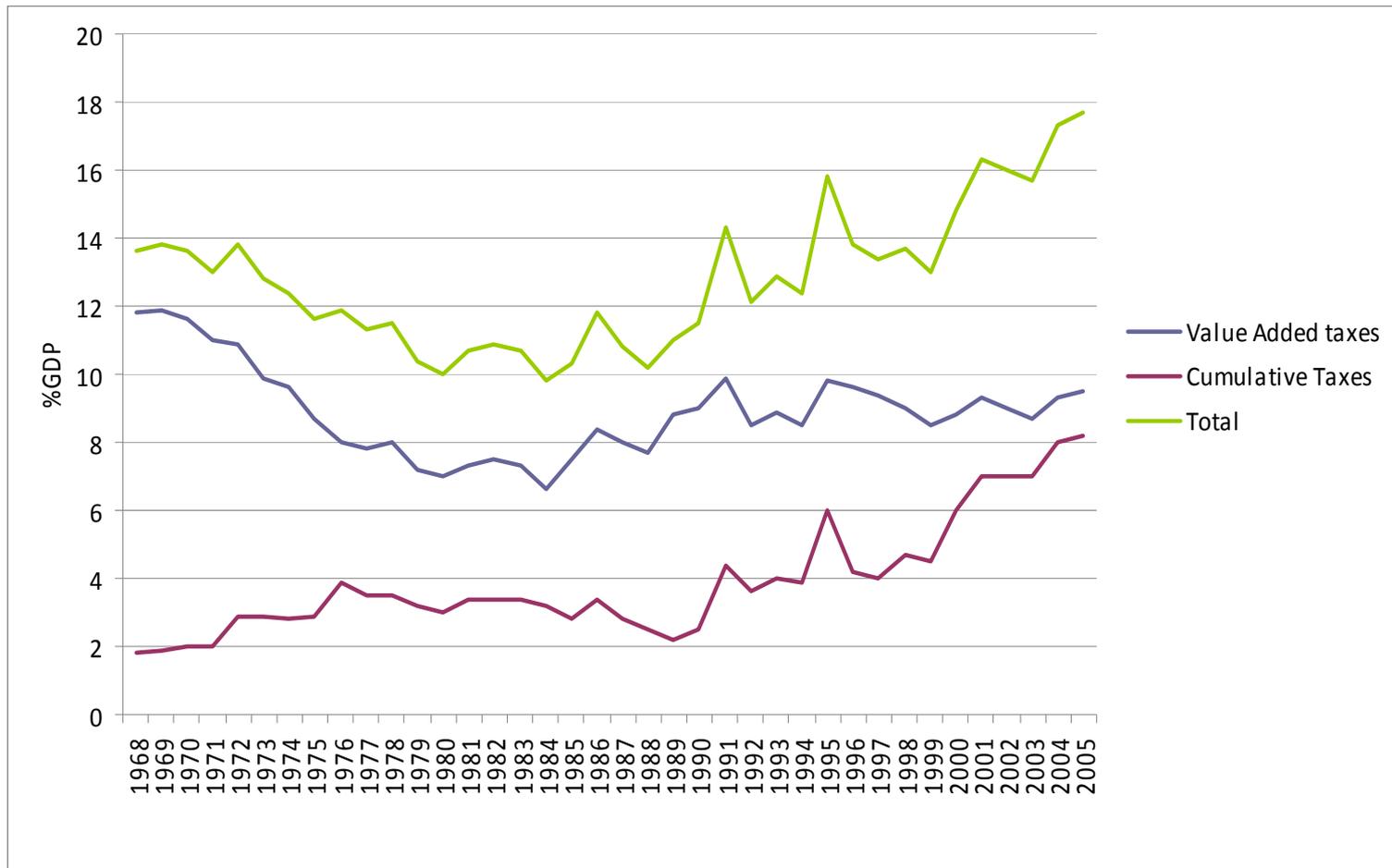
## Consolidated public sector fiscal accounts 2000-2008



# The expansion of social contributions

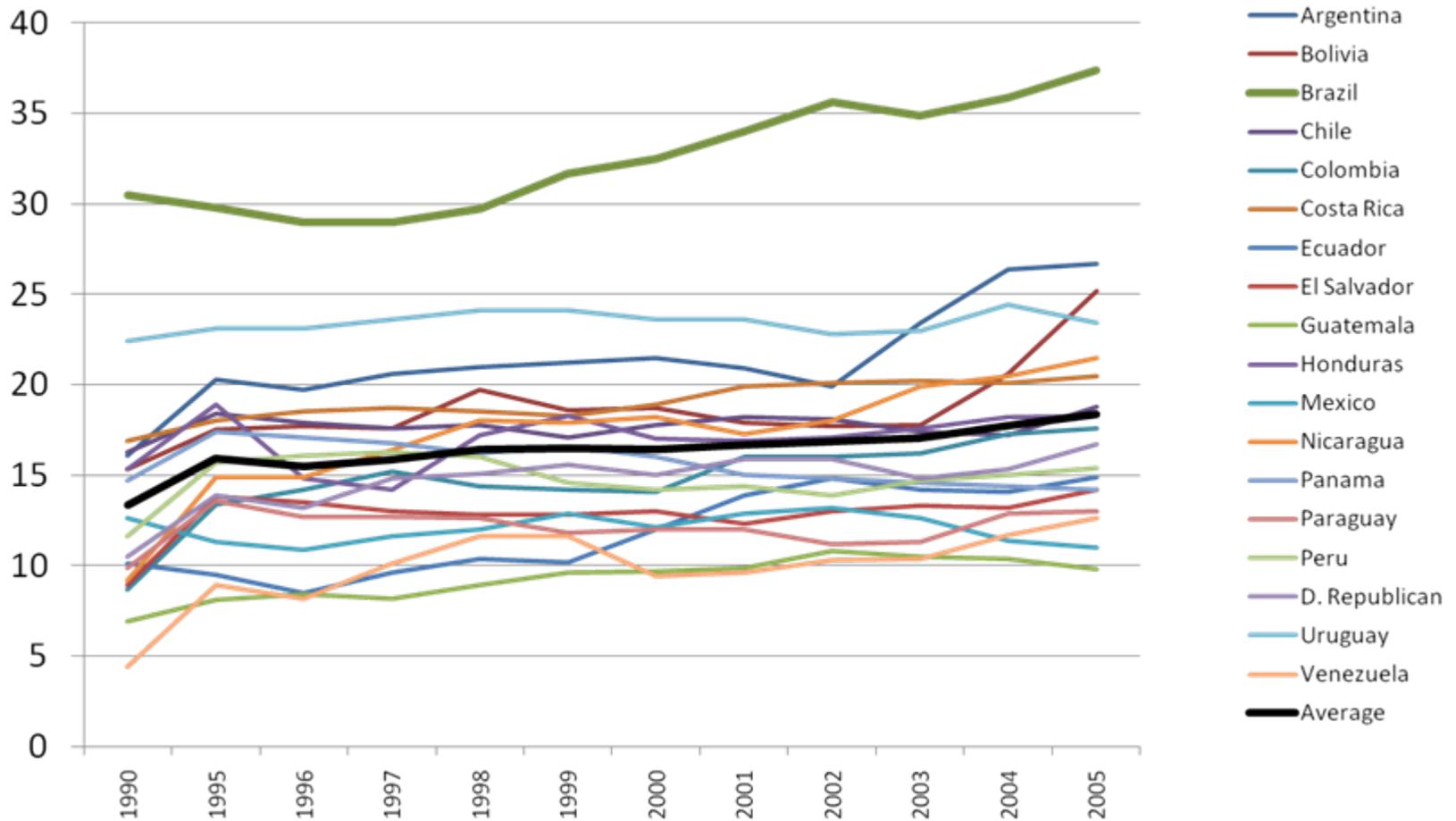


# Cumulative and value added taxes as % GDP, 1968-2005



# An overburdened state

Tax burden in Latin America (1990-2005)



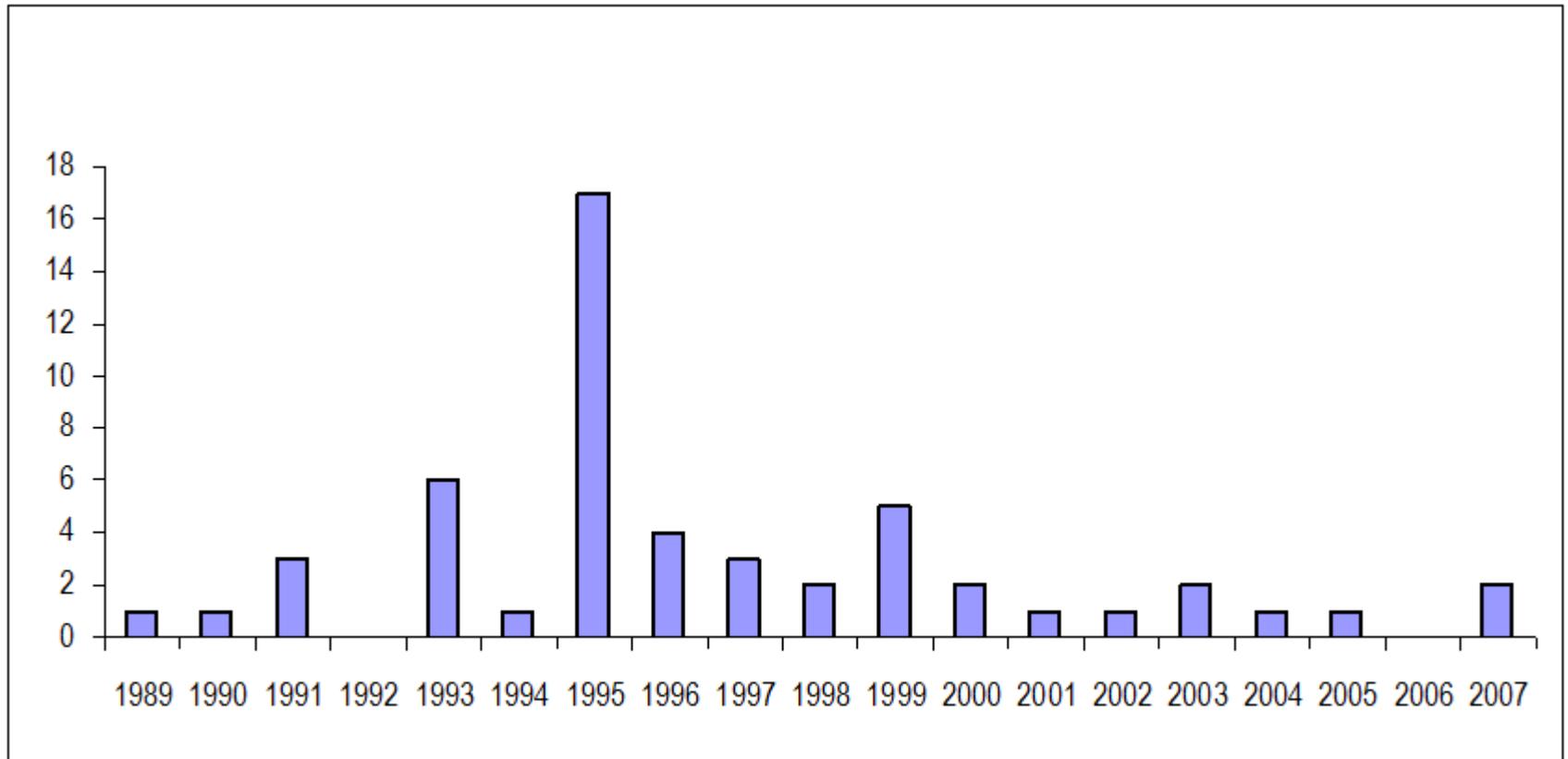
# Incentives to reform ?

- Incentives to reform
  - The political success of the “scandinavian model”
  - Risk aversion /fiscal imperative
    - Preference for revenue generation over efficiency/equity concerns
  - Aversion to institutional reformism
  - A new paradigm shift ?
    - Alternative to cutting rates and broadening base?

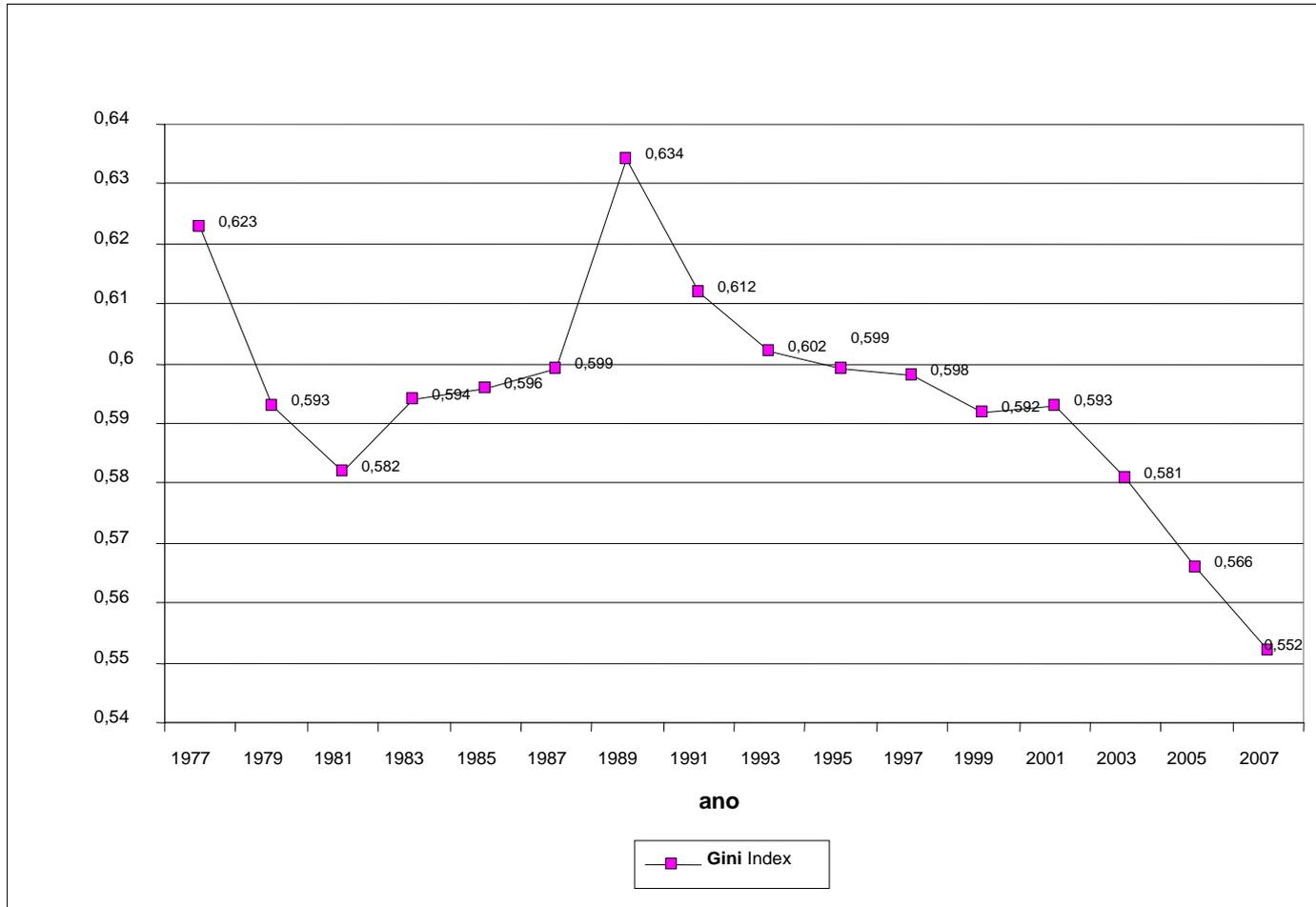
# Political and institutional obstacles to reform?

- Capacity to reform
  - National level veto players? No!
    - Constitutional Powers of Executives
    - Changing the Constitution
    - Coalition governments
  - Subnational veto players? So, so!
    - Issue multidimensionality

# Constitutional reforms in Brazil 1989-2008

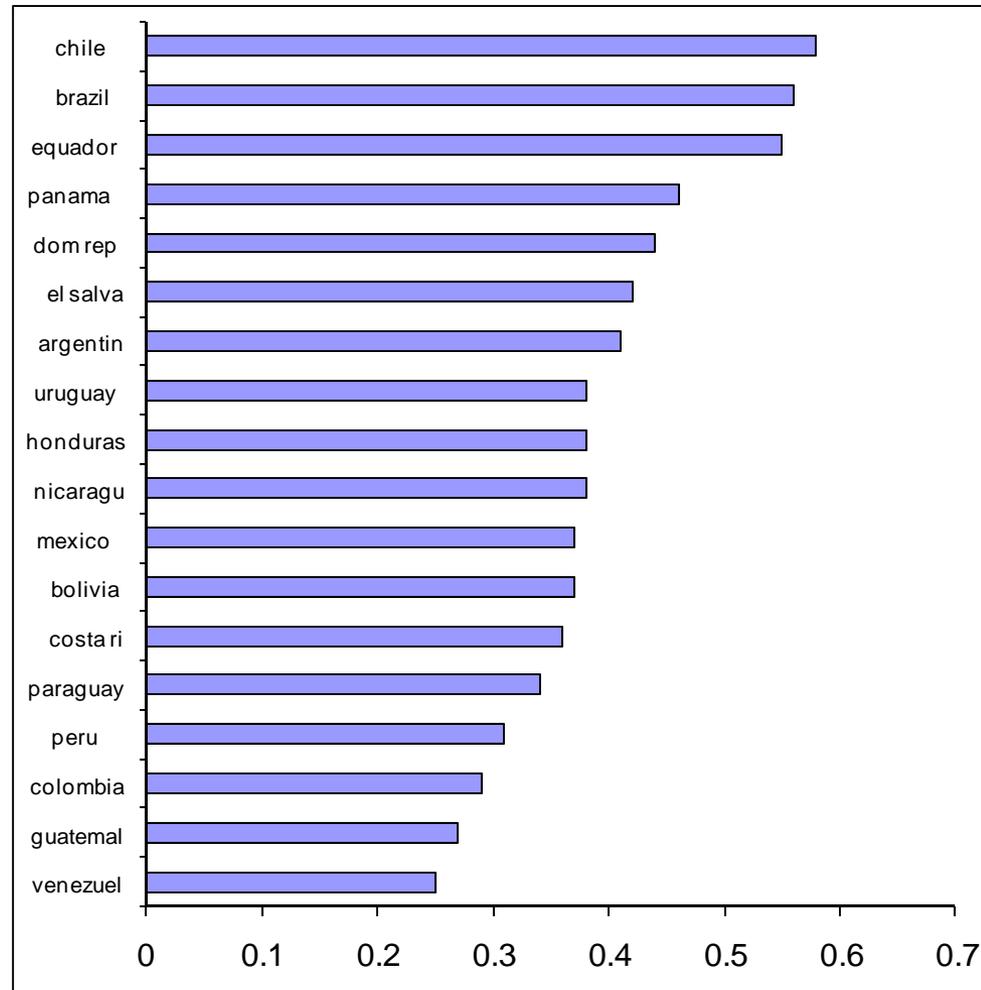


# Redistribution via targeted social expenditures



# Presidents are powerful in Brazil...

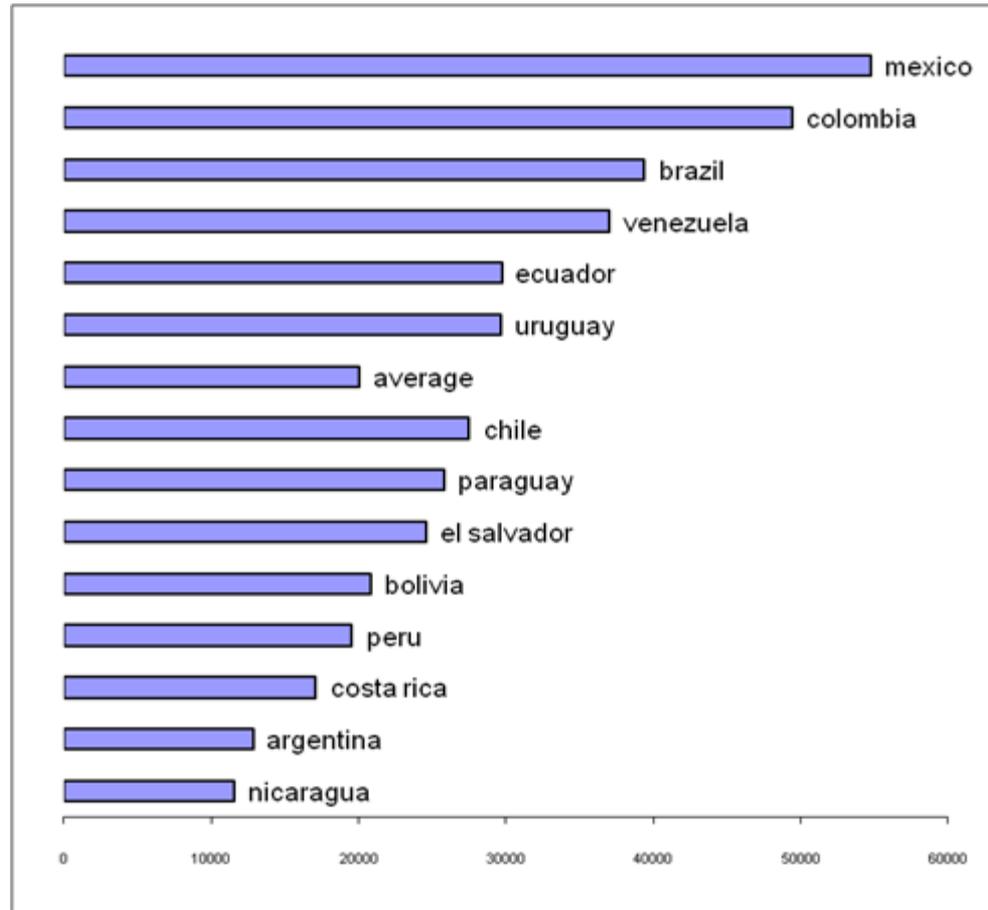
## Constitutional powers of president in Latin America



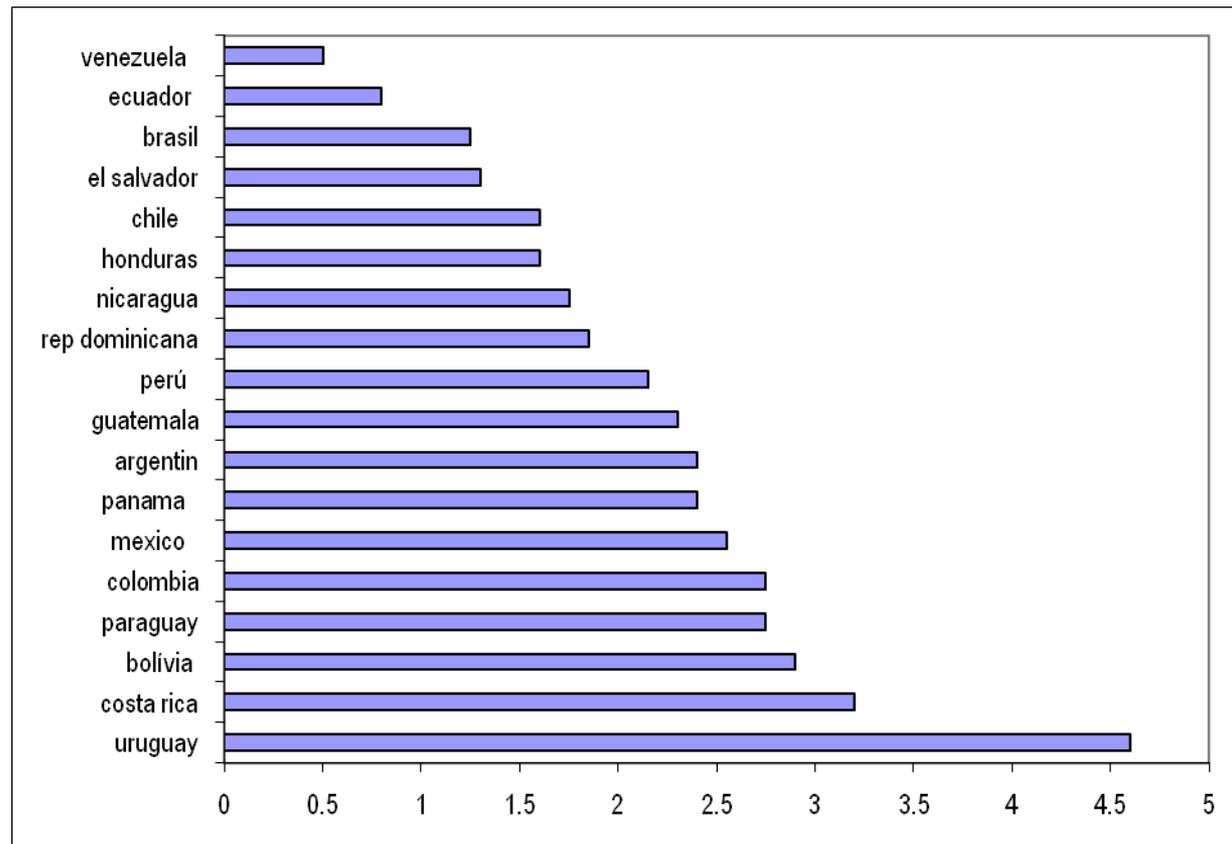
# The constitution and tax reform

- 17 articles (145 to 162) refers *directly* to tax issues
- 3,291 words (approx 10% constitution)
- Reforming consumption taxation is a highly contentious issue.

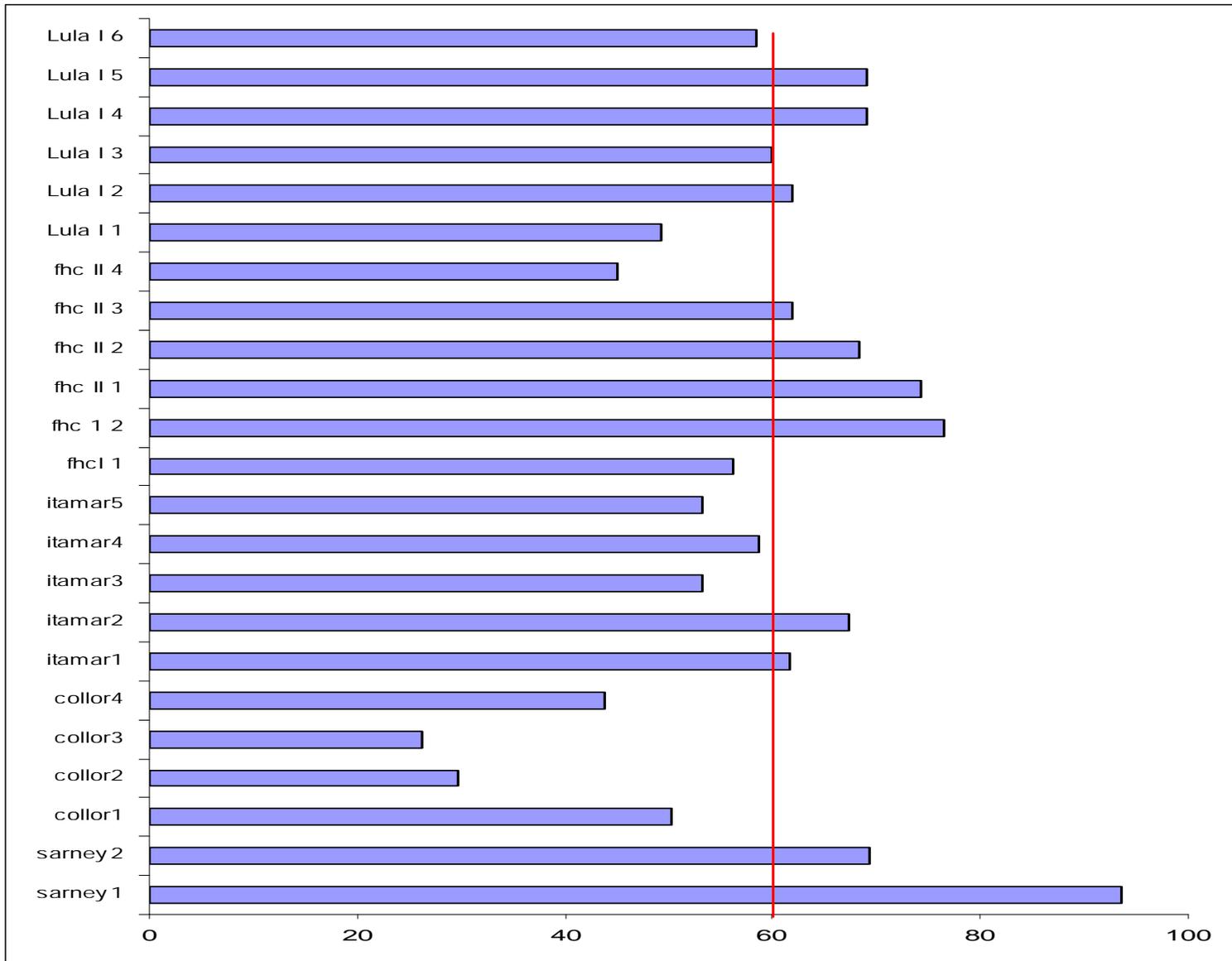
# Length of constitutions



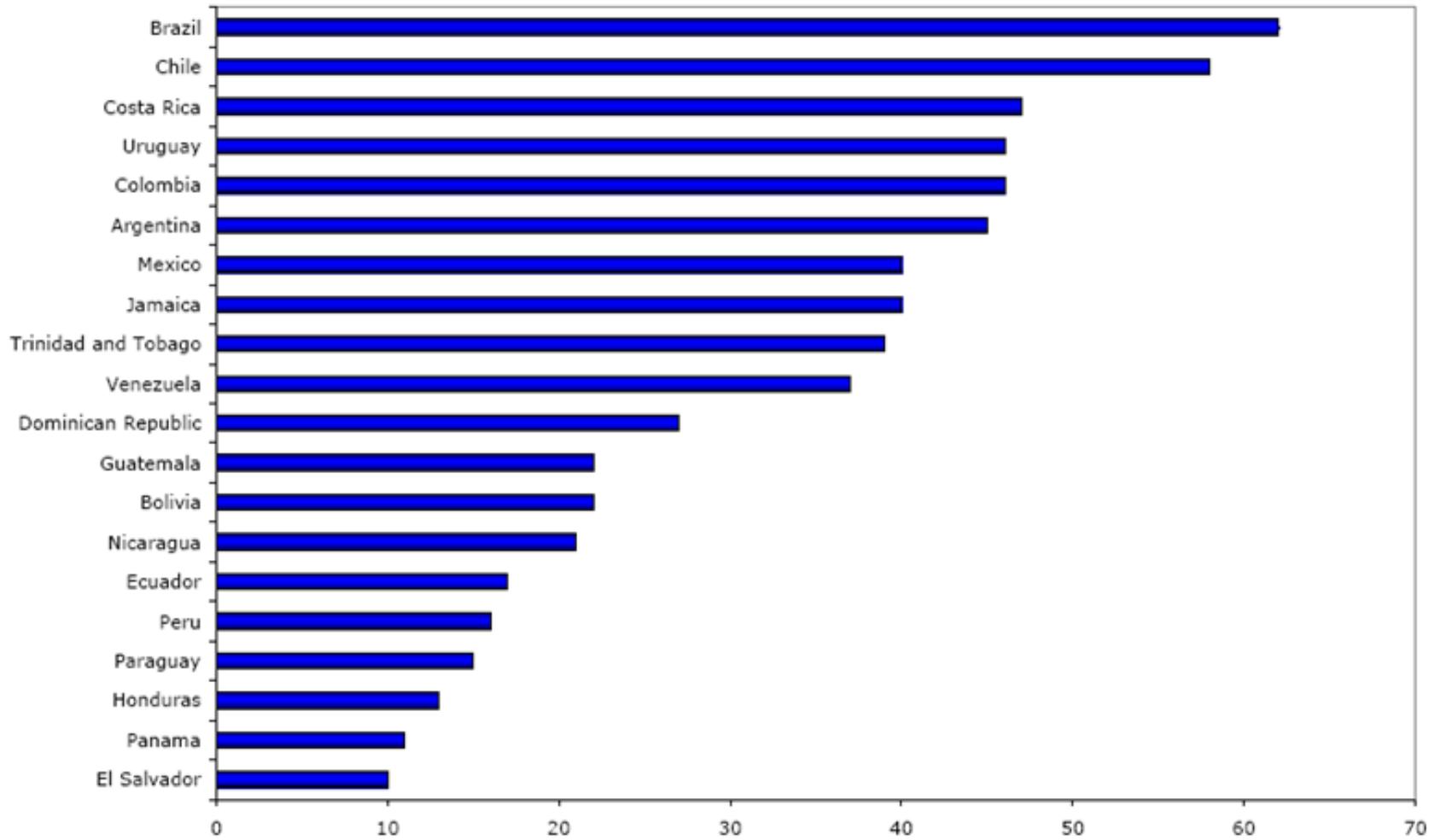
# Constitutional rigidity (lutz index)



# Government coalitions and constitutional supermajority (1985/2006)



# Administrative capabilities

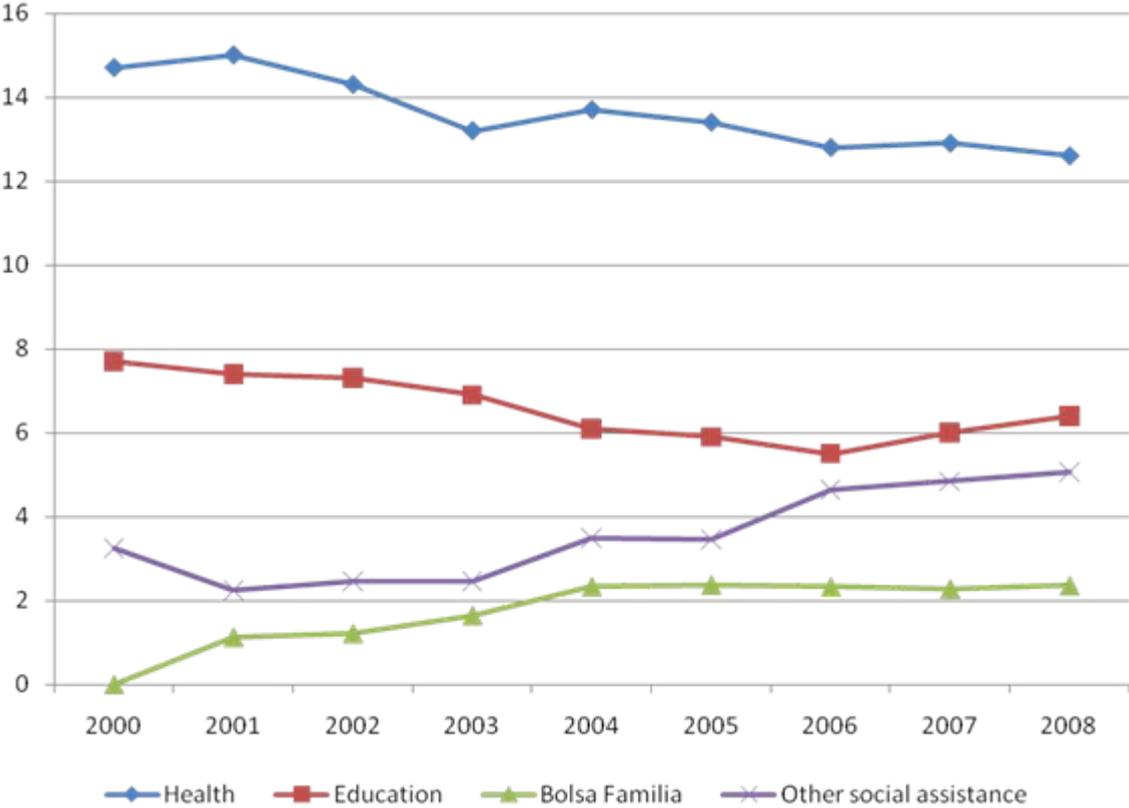


Source: IADB

## Tax burden in Latin America

country	year							
	1970	1980	1985	1990	1995	2000	2005	2008
Argentina	18,5	19,2	18,3	<b>16,02</b>	20,26	21,48	26,84	<b>30,6</b>
Bolívia	8,40	-	-	<b>9,35</b>	14,42	17,95	20,45	<b>22,50</b>
Brasil	23,2	22,7	-	<b>26,36</b>	27,26	30,39	33,33	<b>35,50</b>
Colômbia	11,3	-	-	<b>9,51</b>	13,98	14,93	17,73	<b>21,70</b>
Costa Rica	10,2	12,9	11,5	<b>16,88</b>	17,99	18,85	20,62	<b>23,10</b>
Equador	9,6	10,6	9,1	<b>9,56</b>	9,60	11,62	13,04	<b>16,30</b>
México	11,1	11,9	11,1	<b>11,54</b>	10,12	11,06	10,01	<b>11,90</b>
Nicarágua	-	-	-	<b>9,03</b>	14,16	17,50	20,28	<b>23,00</b>
Rep. Dom.	9,5	11,4	10,1	<b>7,12</b>	10,64	11,33	14,57	<b>16,9</b>
AL	10,7	-	-	<b>13,6</b>	15,50	16,6	17,5	<b>20,9</b>

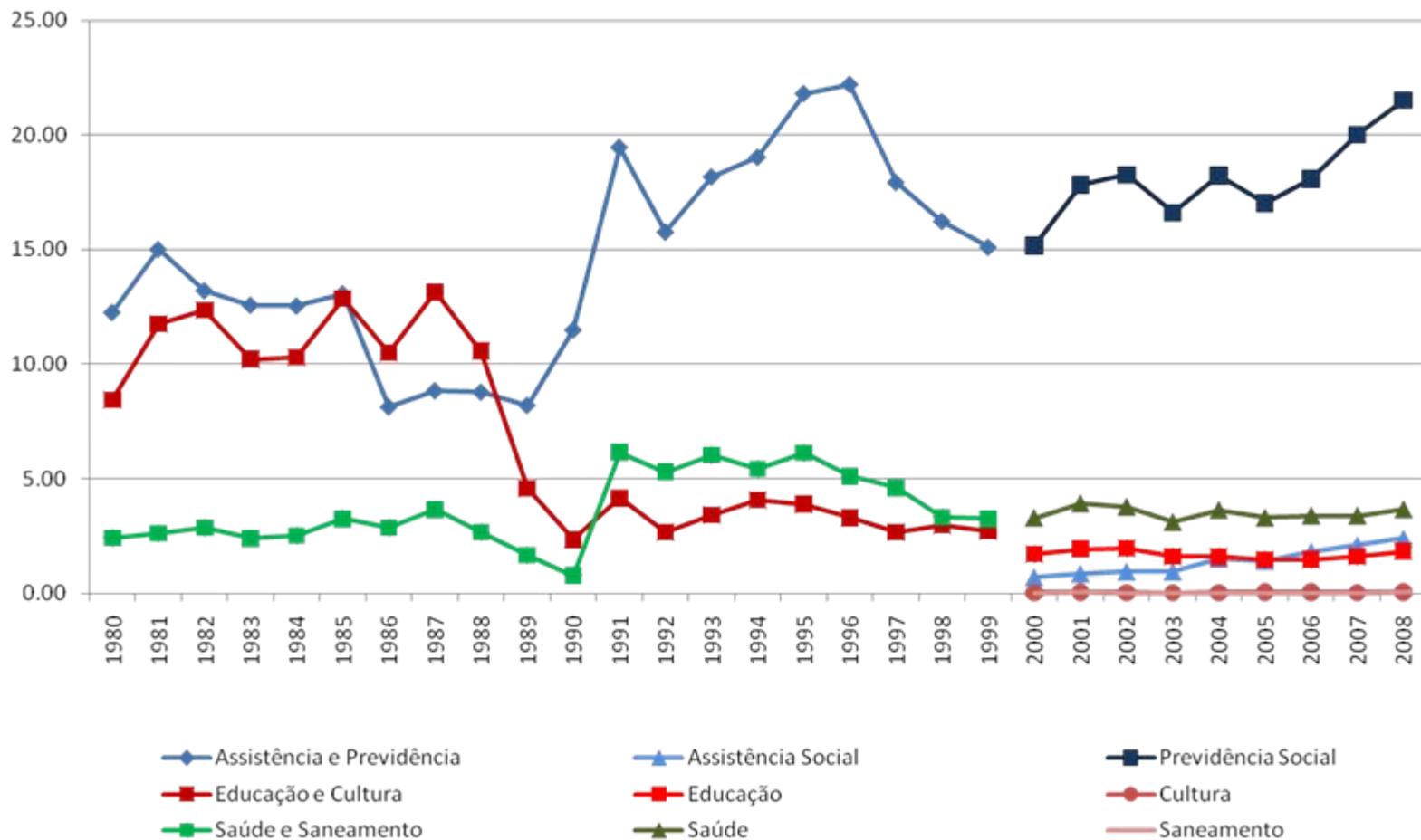
# Gastos sociales federales por funcion % 2000-2008



# Summing up

- Net balance on constraints and capacity to reform but no incentives!
- Scenario: parametric adjustments

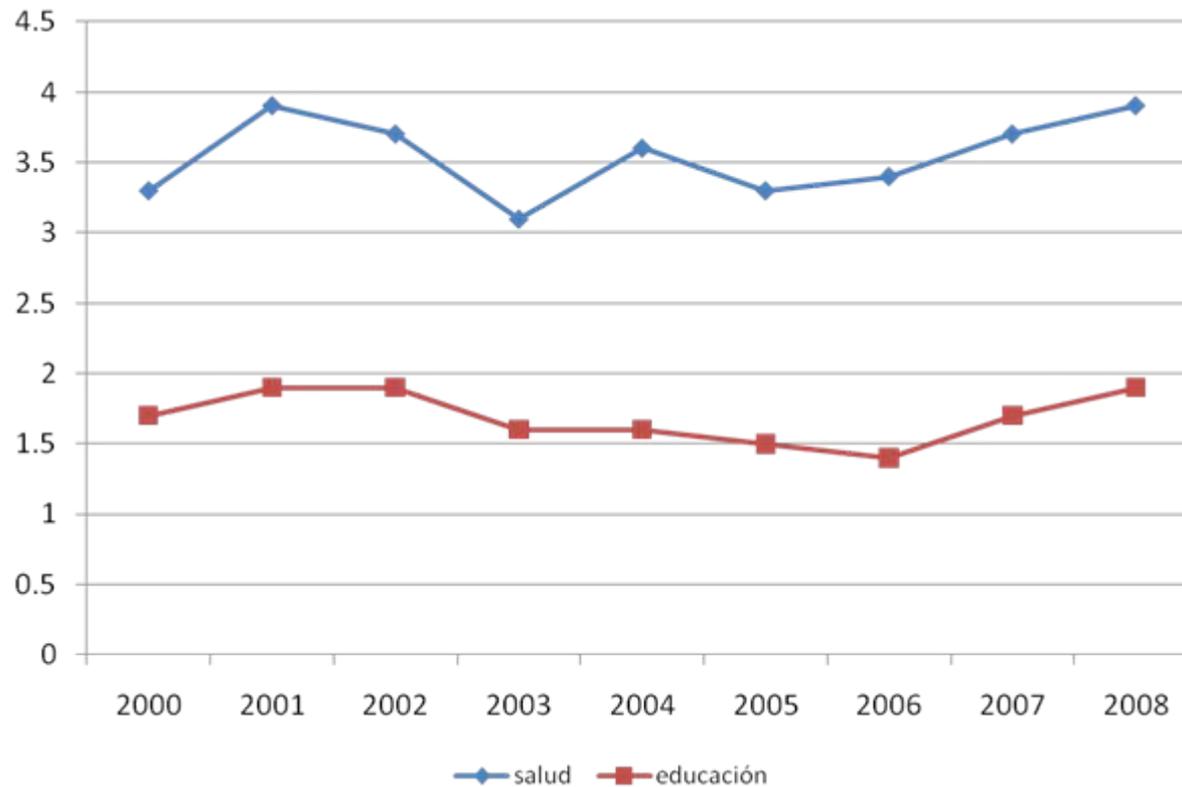
# Social expenditures by function (R\$) 2000-2008



Fonte: SIAFI (STN/MF)

Deflated by IGP-DI, April 2009

## Gasto en salud y educación como as % del total del gasto federal, 2000-2008



<i>Year</i>	<i>Legislation</i>	<i>Status</i>	<i>Scope</i>
1988	Brazilian Constitution	Implemented	<ul style="list-style-type: none"> <li>• States granted a broad-base, value-added sales tax (ICMS);</li> <li>• Revenue-sharing funds increased to benefit states and municipalities;</li> <li>• Base of social contributions widened to compensate for federal revenue losses;</li> <li>• Municipalities assigned a tax on services and property.</li> <li>• Level of overall tax revenues at all tiers not to be reduced;</li> </ul>
1995	Constitutional Amendment Proposal PEC n. 175	Not implemented (dropped after various amendments)	<ul style="list-style-type: none"> <li>• Cumulative social contributions to be changed into non-cumulative and extended as a surcharge on imports;</li> <li>• State VAT to be collected in the state of destination, not origin, as a means to end the “fiscal war”</li> </ul>
1995	Substitute Proposal for the PEC n. 175	Not implemented (approved by a special committee, not voted on the floor)	<ul style="list-style-type: none"> <li>• Uniform state VAT legislation all over the country to be created;</li> <li>• Municipal contributions to be created that finance public security and local services;</li> <li>• Provisional Measures (MP) to be prohibited on most tax issues;</li> <li>• Federal and municipal value-added sales taxes to be created.</li> </ul>
1996	Law 9311	Bill approved in dec 1996	Created the CPMF – tax on financial transactions
1999			CPMF extended
2001	Constitutional Amendment Proposal PEC n. 383	Not implemented (special committee not formed)	<ul style="list-style-type: none"> <li>• Uniform state VAT legislation all over the country to be created;</li> <li>• Local for collection of state VAT, whether at the origin or destination of production, to be established by complimentary law.</li> </ul>
2001	Constitutional Amendment Proposal PEC n. 504	Implemented (converted into Constitutional Amendment n. 31)	Introduces a new Federal contribution for Intervention in the economic domain (CIDE)

2002	“Mini-reform” Provisional measure N 66 (Law 10637)	(converted into Constitutional Amendment n. 39)	The PIS/PASEP contributions were now non-cumulative, and the rate was increased from 0.65% to 1.65%. However, their cascading effects were reduced due to the utilization of tax credits on items at the production stage. The COFINS rate for financial institutions was increased from 3% to 4% and the tax base for the CSLL on the tertiary industries was amplified to 32%.
2003	Constitutional amendment Proposal PEC n.	Both Implemented (converted into Constitutional Amendment n. 42)	Introduces broad changes in tax regime, widening tax base and increasing rates; States are to receive 25% of CIDE’s revenue; municipalities in a state get 25% of the state’s share. Extend the de-earmarking of federal taxes from 2003 to 2007; raise the rate and extend the CPMF (tax on financial transactions).
2004	Constitutional amendment Proposal PEC n.	Implemented (converted into Constitutional Amendment n. 44)	States are to receive 29% of CIDE’s revenue; municipalities in a state get 25% of the state’s share.
2007	Constitutional amendment Proposal PEC n		Extends de-earmarking (FEF) of 20% of federal taxes to December 2011.
2007	Constitutional Amendment Proposal PEC n. 31-A (also known as PEC 255)	Special committee formed, awaits deliberation	<ul style="list-style-type: none"> <li>• Uniform state VAT legislation all over the country to be created;</li> <li>• Turnover and cascading taxes (PIS/PASEP, COFINS) to be converted into a single federal tax;</li> <li>• Provisional contribution on financial transactions (CPMF) to be made permanent;</li> <li>• Non-imposed wealth tax (IGF) to be converted into a social security contribution.</li> </ul>