More than revenue: Taxation as a Development Tool

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Budapest, Hungary
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Taxation as a Development Tool...

– Fight inequality

– Promote productivity

– Protect the future
Taxation as a Development Tool…

Content

– Myths

– Essentials—Some policy reforms
Taxation in LAC: Myth or Reality

Myths?

1. Low tax burden
2. Regressive taxes
3. Large evasion
Myths?

1. Low tax burden

Reality

Yes…particularly in personal income tax…but most significant rise in overall tax burden in the world
Low tax burden in LAC…

Tax Burden as Percentage of GDP
(simple average, 2008-2010)

<table>
<thead>
<tr>
<th>Region</th>
<th>Tax Burden as Percentage of GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>OECD</td>
<td>25</td>
</tr>
<tr>
<td>Eastern Europe</td>
<td>24</td>
</tr>
<tr>
<td>Latin America and the Caribbean</td>
<td>17</td>
</tr>
<tr>
<td>Asia</td>
<td>17</td>
</tr>
<tr>
<td>Africa</td>
<td>16</td>
</tr>
<tr>
<td>Middle East</td>
<td>7</td>
</tr>
</tbody>
</table>
Low tax burden in LAC…

Tax Burden as Percentage of GDP (simple average, 2008-2010)

- OECD: 25%
- Eastern Europe: 24%
- Latin America and the Caribbean: 17% (3% potential given development level)
- Asia: 17%
- Africa: 16%
- Middle East: 7%

Potential given development level
… but not so if considering the Adjusted Fiscal Burden (% GDP), 2010…

Source: BID-CIAT (2012)

• Social Security Contributions include public and private pensions and health systems
...still the Adjusted Fiscal Burden per capita is 10 times less than OECD average...
…but it is converging with OECD…

GDP per capita ratio 90-94

Ratio PIB per capita 90-94

Ratio PIB per cápita 06-10
...and largest increase in burden...

Changes in the Tax Burden between 1990 and 2010
(simple average, percentage of GDP)

Latin America and the Caribbean
Eastern Europe
Middle East
Africa
Asia
OECD
...and in (almost) all taxes (and revenues)...

Structure of Fiscal Revenue in Latin America and the Caribbean (percentage of GDP)

1990-95
- Personal income: 2.8
- Trade: 1.1
- Social Security: 3.0
- Corporate income: 1.9
- Property: 0.4
- Excises: 2.7
- Other: 4.3
- Natural resources: 1.6

2006-10
- Personal income: 4.3
- Trade: 1.9
- Social Security: 4.2
- Corporate income: 1.9
- Property: 1.6
- Excises: 0.5
- Other: 1.7
- Natural resources: 6.3
- VAT: 3.4
- Other: 2.0
...in (almost) all countries in LAC...

Changes in the Tax Burden since the Early 1990s
(percentage of GDP)

- OECD
  - Argentina
  - Ecuador
  - Bolivia
  - Colombia
  - Peru
  - Dominican Rep.
  - Paraguay
  - Jamaica
  - Costa Rica
  - El Salvador
  - Barbados
  - Brazil
  - Uruguay
  - Latin America and the Caribbean
  - Belice
  - Guatemala
  - Nicaragua
  - Panamá
  - Chile
  - Honduras
  - Venezuela
  - Mexico
  - Trinidad and Tobago

-4 -2 0 2 4 6 8 10 12 14

-2.9 -1.1 -1.0 -0.5 -0.6 0.0 0.8 1.0 1.1 1.3 1.1 2.7 3.0 3.1 3.4 3.5 3.6 3.7 3.8 4.4 4.5 6.0 7.9 11.9
...however the gap continues specially for income taxes

**Total Tax Burden Gap, 2007-2009**
(Percentage points of GDP)

- Europa del Este
- OCDE
- África
- Asia
- América Latina y el Caribe
- Oriente Medio
- Brasil
- Barbados
- Belice
- Jamaica
- Argentina
- Nicaragua
- Uruguay
- Honduras
- Bolivia
- Chile
- Perú
- Colombia
- Ecuador
- Haití
- Rep. Dominicana
- Paraguay
- El Salvador
- Costa Rica
- Venezuela
- Guatemala
- Trinidad y Tobago
- Panamá
- México

**Income Tax Burden Gap, 2007-2009**
(Percentage points of GDP)

- OCDE
- Asia
- África
- Europa del Este
- América Latina y el Caribe
- Oriente Medio
- Jamaica
- Barbados
- Nicaragua
- Belice
- Brasil
- Chile
- Honduras
- Perú
- Colombia
- Trinidad y Tobago
- Haití
- Ecuador
- Venezuela
- Bolivia
- El Salvador
- Panamá
- Guatemala
- Paraguay
- México
- Rep. Dominicana
- Costa Rica
- Argentina
- Uruguay

Taking into account GDP  Taking into account other variables
Where are the differences between LAC y OECD?

Difference LAC with OECD
Average 2000 - 2010

Corporate taxes 4%

Personal taxes 52%

Others 44%

Taxation in LAC: Myth vs. Reality

Myths?

1. Low tax burden
2. Regressive taxes

Reality

Yes...particularly in personal income tax...but most significant rise in overall tax burden in the world

Maybe...with losses to avoid VAT regressivity
...and to promote progressivity of personal income taxes
Regressive VAT? Measurement matters

Incidence of VAT by income and consumption deciles

Income and consumption deciles

Average effective rate (percentage of consumption)

Average effective rate (percentage of income)
Productivity and efficiency of VAT

VAT Productivity and Efficiency
(Index=0-1, where 1=maximum productivity)

C-Efficiency (VAT Revenue Ratio, VRR) measures the difference between the VAT revenue actually collected and what would theoretically be raised if VAT was applied at the standard rate to the entire potential tax base.
Tax expenditure not always yields progressivity

Tax Expenditure and Progressivity

Ratio of effective tax rates of deciles 1 and 2 with respect to 9 and 10
Personal income tax: Design on paper…

Maximum Marginal Rate for Each Income Level, 2010

Other middle-income countries

Latin America and the Caribbean

Rate

Income level (number of times per capita income)
…that barely reaches wealthy households…

Tax Wedge for Employee without Children in Sixth decil
(Percentage of the salary)

OECD
- Social security contribution by employer: 15
- Social security contribution by employee: 9
- Personal Income tax: 13

Latin America and the Caribbean
- Social security contribution by employer: 11
- Social security contribution by employee: 13
- Personal Income tax: 13
...and ends up an empty shell

Income decile

Incidence of Personal Income Tax

- Poor design
- Generous deductions
- Evasion

80% of population pays 0%
The very rich pay only 4%
...and ends up an empty shell

Incidence of Personal Income Tax

- Poor design
- Generous deductions
- Evasion

80% of population pays 0%
The very rich pay only 4%

Change in income distribution before and after taxes = 0.008
Progressive on paper...with NO real redistributive power
Taxation in LAC: Myth vs. Reality

Myth?
1. Low tax burden
2. Regressive taxes
3. Large evasion

Reality
Yes…particularly in personal income tax…but most significant rise in overall tax burden in the world
Maybe…with losses to avoid VAT regressivity
…and to promote progressivity of personal income taxes
Yes… in income taxes (lower in VAT)
It’s easy and risk free to evade
Large evasion: A blow to equality

**Tax Evasion Rates**
(percentage)

- **Corporate Income Tax**
- **Personal Income Tax**
- **VAT**

The graph shows the tax evasion rates for Corporate Income Tax, Personal Income Tax, and VAT.
...with minimum chances of being audited

3% Mass audits
...with minimum chances of being audited

3% Mass audits

0.2% In-depth audits
Nonetheless, positive results from reforms...  

1990-2004

Corporate Income Tax

Personal Income Tax

Valued Add Tax

Note: "Increase" refers to those reforms that implied the creation of a tax, the broadening of the tax base, or a rate increase
...with advances on environmental taxes...

2009

- Japan
- Switzerland
- Australia
- United Kingdom
- Netherlands
- Korea
- Mexico
- Colombia
- Peru
- Argentina
- Uruguay
- Chile
- Guatemala
- Costa Rica
- Dominican Rep.

% of GDP
...and with necessity to promote productivity

2009/10

Source: World Bank, World Development Indicators 2009 and Schneider, F., A. Buehn and C. Montenegro (2010), shadow economy uses multiple indicator multiple cause (MIMIC) model to estimate the shadow economy econometrically with a structural equation with one latent variable.
To collect is essential but not enough—some policy reforms

<table>
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<td>Reduce minimum exempt level</td>
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<td>✓</td>
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<td>Phase out special regimes</td>
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<td></td>
<td></td>
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<tr>
<td>Reduce tax incentives</td>
<td>✓</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Decrease rates?</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>VAT</strong></td>
<td>?</td>
<td>✓</td>
<td>✓</td>
</tr>
<tr>
<td>Eliminate exemptions; unify rates</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Compensate poor households</td>
<td></td>
<td></td>
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<td>Reduce payroll taxes?</td>
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To collect is essential but not enough—some policy reforms

**Personal Income Tax**
- Reduce minimum exempt level
- Cap deductions progressively
- Adopt a dual income tax

**Corporate Income Tax**
- Phase out special regimes
- Reduce tax incentives
- Decrease rates?

**VAT**
- Eliminate exemptions; unify rates
- Compensate poor households
- Reduce payroll taxes?

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Strengthen tax administration and combat evasion