1

Introduction: The Political Economy of Taxation in Latin America

Gustavo A. Flores-Macías

As the scandal of the Panama Papers – the leak of millions of records in 2016 from a law firm's list of clients with shell companies in offshore tax heavens – revealed, individuals will go to great lengths to avoid taxation. In one case, a wealthy Mexican businessman had established a half-dozen offshore corporations to evade taxes, and, in the aggregate, his unpaid taxes on foreign accounts are estimated at around US$100 million. The government of Costa Rica found at least 410 offshore companies set up by that country's nationals. Overall, 22% of Latin America's financial wealth is believed to be offshore, representing about US$21 billion in foregone government revenue (Zuckman 2015). By most accounts, the leak revealed only the tip of the iceberg.

Although the prominence of the Panama Papers might imply that only economic elites engage in this behavior, resistance to paying taxes takes place at all levels. As former Guatemalan finance minister, Juan Alberto Fuentes Knight (2012, 22), laments about recent efforts to integrate business units of all sizes into the fiscal system: "It is well known that in practice, many companies keep three books: what they show to the tax authority that reflects extremely low profits or losses in order to pay low taxes; what they show to the banks to get loans, where they increase their profits to appear very successful; and the true accounts, that are secret." These examples are emblematic of a long-standing challenge in the political economy of development: how to make taxation palatable.

In spite of this generalized animosity, however, there is an increasing consensus about the salutary consequences of taxation in terms of state capacity, government accountability, and economic development. For example, taxation is considered a fundamental source of resources that can translate into state strength (Brautigam et al. 2008; Schneider 2012). It can generate links of accountability between citizens and rulers that make governments more responsive (Paler 2013; Tilly 2009). It can contribute to addressing inequality (de Ferranti et al. 2004; Mahon Jr. 2012) and promoting growth (Bird 2012; Canavire-Bacarreza et al. 2013), and, for these reasons, taxation is considered an essential tool for development (Evans 1995; Inter-American Development Bank 2013). Not surprisingly, calls by think tanks (e.g., Council of Foreign Relations 2014) and international organizations (e.g., CAF Banco de Desarrollo de América Latina 2012; Inter-American Development Bank 2013) for increasing fiscal extraction in the developing world have gained momentum in recent years.

Yet, in spite of the importance of taxation for these different areas, the attention on taxation has been largely concentrated in the design of tax systems (Santos de Souza 2013). Existing scholarship on the design of tax systems has been extensive at presenting a diagnostic of the state of taxation in the region and the nature of the reforms needed. For example, we know that extraction in Latin American countries is low compared to that of other countries at similar stages of development; that although taxation is generally low, there is considerable variation in fiscal extraction across countries; that the region's tax structures tend to favor indirect over direct taxes; and that evasion tends to be high compared to other places (OECD 2016). Given these considerations, common prescriptions have been the simplification of tax systems, the modernization of tax revenue administrations, and the elimination of exceptions and tax incentives – to name a few – in order to promote efficiency and minimize distortions in the economy.

This emphasis, although an important step in identifying the direction of reform, has come at the expense of the political factors associated with the successful adoption of reforms. With notable exceptions, most studies on fiscal policy in Latin America have tended to ignore the political underpinnings of taxation. This is a significant oversight because political conflicts are at the heart of the obstacles to reforming tax systems. As Wagner Faegri and Wise (2011, 246) have noted,

> Despite the central role of taxation in economic development and growth, political economists have yet to develop a program of research that fully captures the politics of tax reform in emerging-market economies. Although legislative coalitions for economic reform have emerged in even the most contentious political environments, tax reform remains one of the more contested and understudied issues in Latin America.

This volume explores the role that political factors play in addressing the region's fiscal challenges. In particular, it tackles three main questions of the political economy of taxation in Latin America: What explains the region's low levels of taxation? What accounts for the region's tax structure? What explains differences across countries? By answering these questions, this book can inform efforts to address the region's taxation shortcomings.

In particular, the volume shows that commodity prices generate strong incentives for cycles of resource nationalism – encouraging certain governments to make poor tax decisions when entering into contracts – but also suggests that there is room for less structural factors to shape the levels and incidence of tax collection. For example, levels of taxation are shaped by the strength of economic elites, state capacity and compliance, and patterns of economic incorporation. Further, electoral rules, interest groups, and public opinion can play an important role in explaining differences in the tax structure, although there is significant crossover between groups because much of the region's low tax collection is related to the "missing share" of direct taxes. Differences in government's commitment to public spending, institutional strength, elite power, and electoral rules are helpful to account for considerable variation across countries, from Brazil's remarkable 34% at the top to Mexico's paltry 11% at the bottom.

Naturally, different courses of action often involve important tradeoffs. A policy that makes taxes politically palatable may increase fiscal revenue but at the same time affect other important considerations in the design of tax systems, such as efficiency or equity. For example, while there is evidence that earmarking taxes reduces animosity toward increasing the tax burden (Flores-Macías 2015; 2018), these taxes might reduce efficiency in the tax system (Buchanan 1963; Goetz 1968). Yet, it is important to know the full spectrum of options and their tradeoffs to know what governments can draw on given each country's particular circumstances. Technically desirable courses of action can only go so far without the ability to generate the political conditions for their approval.

FROM RESOURCE BOOM TO FISCAL PINCH: THE RENEWED IMPORTANCE OF TAXATION

Paying taxes is perhaps one of the least popular activities for people across the world. In the United States, for example, public opinion surveys consistently show the percentage of people who believe their taxes are too high at about 50%, whereas only 3% express that the tax burden is too low (Riffkin 2014). Attitudes toward taxes are similar in Latin America. In Chile, for example, 64% of respondents in a nationally representative survey suggested the tax burden should be lowered, compared to 9% who stated it should be increased (Fundación Jaime Guzmán 2011). In Mexico, only 5% of respondents in a similar survey suggested that taxes should be raised, whereas 64% stated they are too high (Centro de Estudios Sociales y de Opinión Pública 2013). These percentages have remained remarkably stable over time.

In spite of the continuous unpopularity of taxes, however, fiscal extraction has gained renewed interest in Latin America due to governments' newfound urgency to find sustainable sources of revenue. The commodity boom that began in 2003 and ended in 2014 became a major source of revenue for governments across the region (Monaldi 2014). The revenue windfall from exports of hydrocarbons, minerals, and agricultural products – often at record prices – greatly benefited government coffers. It allowed governments to improve budget balances and expand expenditures.[1] It also allowed them to increase official reserves and pursue countercyclical measures to cushion the impact of economic crises (Ardanaz et al. 2015, 4; IMF 2015).

However, commodity prices declined sharply in 2014, with many commodities by 2019 valued at less than half of their peaks during the decade-long boom. A prominent case is the price of oil, which stabilized at about $40–50 per barrel by mid-2015 – less than half of its value a year earlier, and a fraction of its peak of $143 in 2008.[2] This experience of oil – along with other hydrocarbons more generally – is not atypical; metals such as nickel, copper, silver, and gold – important exports for Andean countries such as Peru, Colombia, and Chile – have followed similar trends. The price of agricultural products such as soybeans – important for Argentina, Brazil, and Paraguay – have seen comparable decreases. Although current prices are not as low as those prevailing in the early 2000s before the onset of the boom, they have discouraged production, resulting in turn in lower revenue from royalties and taxes.

In Colombia, for example, where oil revenue represented a fifth of government revenue (Schipani 2015), oil production has plateaued after

[1] For example, governments across the region engaged in significant fiscal stimulus programs as a response to the 2008–2009 global economic recession.

[2] Constant prices in 2015 US dollars: www.macrotrends.net/1369/crude-oil-price-history-chart

a period of sustained growth between 2004 and 2013. In 2015, drilling declined by 25%, and the government is considering exempting oil companies from paying income taxes to address a decline in production, which is expected to drop below the government's target of 1,000 million of barrels per day (Willis 2015). In Mexico, where more than a third of government revenue comes from oil and the expected investment interest in the recently privatized oil industry has not materialized, production has steadily declined to its lowest point (1.9 million barrels per day [mb/d] in 2017) in at least two decades (Paraskova 2018) – a 24% decline since 2014 and 50% since its peak of 3.85 mb/d in 2004 (Flores-Macías 2016; Lajous 2014, 8). In both places there were high fiscal expectations riding on commodity prices before the panorama changed significantly.

A problem the region now faces is that increases in government spending based on temporary sources of revenue, while generally beneficial while they last, become difficult to roll back once the sources of revenue dry out (IMF 2015; World Bank 2016). People quickly get used to the higher levels of government expenditure, which become perceived as entitlements rather than temporary measures. In the aftermath of the global recession and the end of the commodity boom, governments have, by and large, failed to pare down the increases in spending since 2009 (IMF 2015). According to the International Monetary Fund (2015), spending-to-GDP ratios are about four percentage points of GDP higher on average today than their pre-crisis levels in 2007.

Due to the combination of reduced revenue from commodity exports and increased spending to cope with the global recession, fiscal balances across the region have deteriorated in spite of the sustained economic recovery following the crisis. Although several countries have adopted measures that have ameliorated the negative effects of the decline in commodity prices – including greater flexibility in the exchange rate and fiscal policy rules – the decline was so sudden and pronounced that it has had negative consequences across the board (Caceres and Gruss 2015, 51). As Figure 1.1 shows, the average fiscal balance as a share of GDP reached its lowest point in 2015 since the start of the boom. The difference is considerable when compared to the peak of the boom right before the 2008 crisis, when the region even experienced a surplus.

Although commodity prices behaved similarly for a number of goods, including metals, food, and oil (Figure 1.1), there is variation across countries as to the importance of the commodity boom for government coffers. As Figure 1.2 suggests, several countries leveraged the commodities boom to achieve surpluses between 2003 and 2012, including Argentina, Chile,

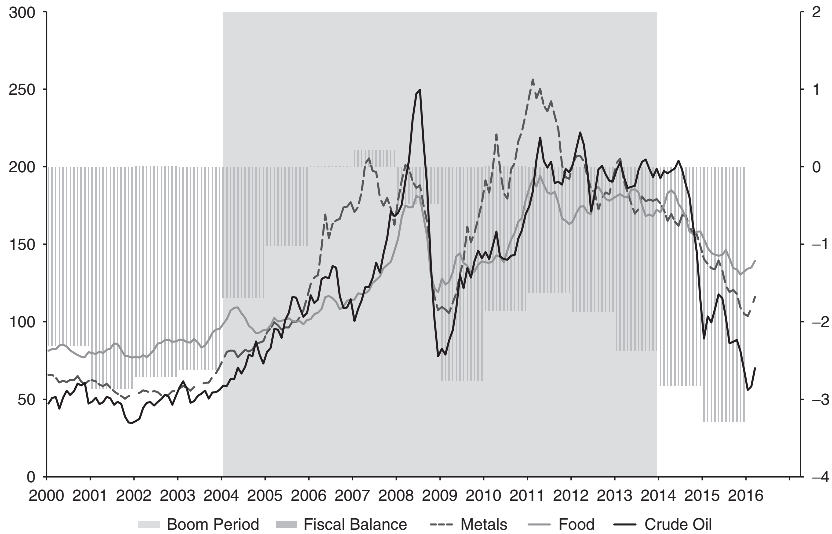

FIGURE 1.1 Commodity prices and Latin America's fiscal balance
NB: Left axis corresponds to the Indexes for Metals, Food, and Crude Oil (2005=100). Right axis corresponds to fiscal balance as a share of GDP. Fiscal Balance for 2015 is estimated with latest data available.
Source: Generated by the author with data from the IMF World Economic Outlook Database and CEPAL

Ecuador, Paraguay, and Peru. Others, such as Brazil, Colombia, Mexico, and Uruguay, did not achieve an average surplus during this period but improved their fiscal balances. However, all countries' bottom lines have suffered since the end of the boom. Whereas fiscal balances in Colombia, Nicaragua, and Peru have deteriorated by less than 1.2 percentage points of GDP since 2013, Argentina, Chile, and Ecuador have suffered decreases of more than 3.7 points. Although Venezuela is not included in Figure 1.2 because of lack of data, the impact of the end of the commodity boom is likely worst in that country, where oil generates more than 80% of the country's export revenue and about 45% of the government's revenue.[3]

Contrary to the favorable international outlook during the first decade of the twenty-first century, this bleak fiscal outlook for Latin America is taking place in the context of much less favorable international conditions. The global economy has decelerated, and perspectives for the

[3] There has been little transparency in Venezuela's reporting of government data since Hugo Chávez's presidency.

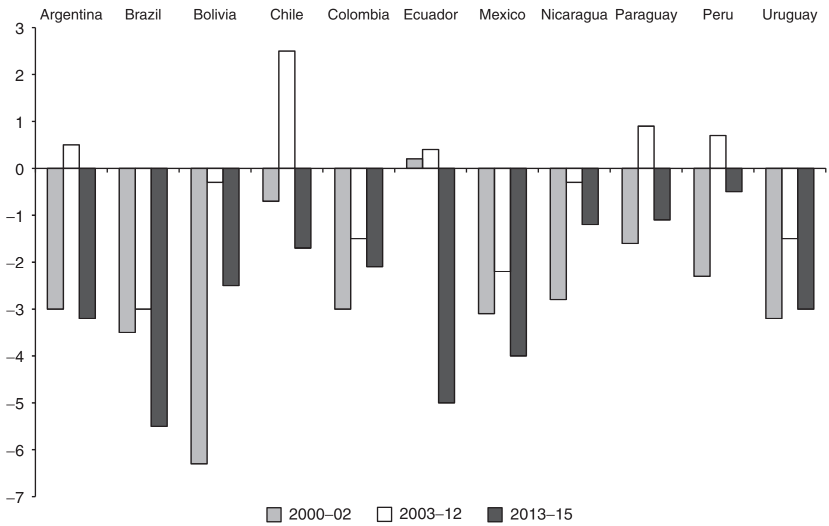

FIGURE 1.2 General government balance, selected countries (% of GDP)
Source: Zhang (2016)

region's economic performance are much less rosy than over the previous decade due to tightening interest rates and higher borrowing costs. Growth in emerging economies is showing signs of less dynamism, with China and India struggling to maintain the spectacular rates of recent years. China's economy has grown at rates below 8% for five years in a row since 2013. The rates of 6.7% for 2016 and 2017 are the country's lowest since 1990 – far from its peak growth of 14% in 2007 (Magnier 2016; Hsu 2017). India's growth has also decelerated from a high of 10% in 2010 to 7.1% in 2016, and 6.8% in 2017 (BBC 2016; Times of India 2017). The decreased dynamism of these two countries has not only contributed to the end of the commodity boom, but also to a decrease in demand for Latin American exports more generally.

At the same time, the US Federal Reserve has begun to raise interest rates. This will lead to higher borrowing costs, translating into both a greater burden from servicing existing debt denominated in US dollars and an increased cost of borrowing in the future. These factors, along with US president Donald Trump's proclivity toward protectionism, are likely to further decelerate the global economy. In 2016, for example, the region contracted by 1% on average, with Brazil and Venezuela contracting by 3.5 and 8.3% respectively (World Bank 2016). In 2017, regional growth was a meager 0.9%. This leaves Latin America in the unenviable situation of having to look for sources of revenue beyond those from natural resources at a time of international economic turbulence and low growth prospects.

Otherwise, the deteriorating fiscal situation will have important consequences for the region. In particular, spending cuts tend to affect the provision of public goods. This in turn negatively affects the most vulnerable sectors of society, who are not normally able to afford private alternatives. In Mexico, for example, the government has cut public spending by between 0.5% and 1.5% of GDP each year between 2015 and 2018 (Flores-Macías 2016; Graham 2017). In Brazil, a drastic provision limiting government spending for 20 years was approved in 2016 (Paraguassu and Marcello 2017).

Further, governments will become less able to address sudden crises by engaging in fiscal stimuli to soften the blow through countercyclical measures, as they did in 2008–2009. Instead, they are likely to find themselves faced with the conundrum of having to respond to a crisis but also having to put the fiscal house in order, which would likely worsen the crisis. This increases the chances that governments disregard existing fiscal rules in order to face short-term spending needs (IMF 2015). Fiscal buffers must be rebuilt before the next real crisis hits. Otherwise, the same tool used effectively during the 2008–2009 recession will not be available in the future. As the Latin American experience clearly shows, procyclical policies have been found to undermine growth (Ardanaz et al. 2015).

BEYOND COMMODITY BOOMS: LATIN AMERICA'S PENDING FISCAL ASSIGNMENTS

While the end of the commodity boom has brought the need for increased fiscal extraction to the fore of the region's policy agenda, it also serves as a reminder of unaddressed fiscal problems with which Latin American countries have struggled for decades. In particular, two main pending assignments are low levels of fiscal extraction and the tax structure's low contribution to addressing inequality.

Extraction Levels

First, while there has been some improvement over the last quarter century, the region's fiscal extraction remains lower than would be expected for its level of economic development. To be sure, the region has come a long way compared to the period of large fiscal imbalances coupled with high inflation – which eroded the real value of tax revenue – that resulted from the debt crisis during the 1980s. At the time, countries across the region responded to the crisis by slashing public expenditures and adopting policies aimed at generating fiscal revenue.

Since then, governments have made important strides in modernizing their tax revenue administrations, simplifying tax systems, broadening tax bases, and reducing the number of exceptions and tax incentives (Prichard and Moore 2018; OECD 2016, 25). For example, many countries have expanded their tax systems to include all labor and capital income – including dividends – and introduced minimum taxes based on presumptive taxation along with controls for transfer prices (Tanzi 2008; OECD 2016, 25).

This trend is encouraging, but much remains to be done. Even with these important strides in tax collection, Latin American countries generally collect less than their potential. With a handful of notable exceptions, most countries' tax-to-GDP ratios range between 10 and 20%. As Figure 1.3 shows, this is not only lower than what most OECD countries collect, but also below the expected ratio for middle-income countries. The majority of the region's countries are a full five percentage points below their expected levels of taxation.

Yet, in spite of Latin America's generally low levels of taxation, there is variation across the region in terms of revenue generation. Whereas

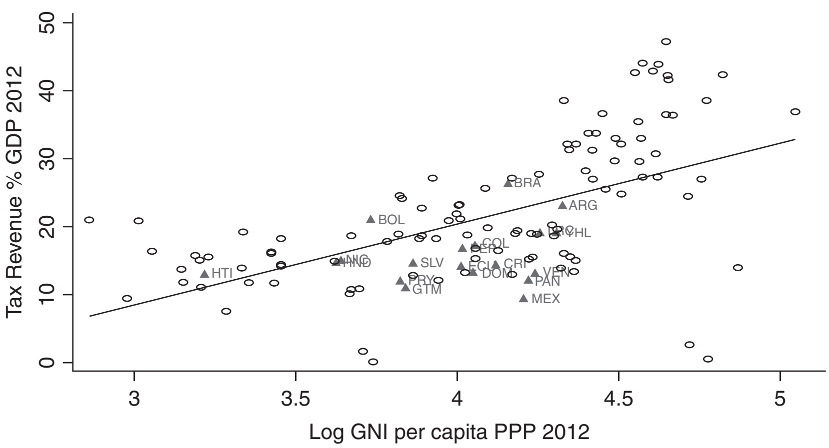

FIGURE 1.3 Tax-to-GDP ratio by income level (central government)
Source: UNECLAC (2018), OECD(2018), and World Bank WDI (2018)

Guatemala and Mexico record extremely low levels of fiscal extraction with tax-to-GDP ratios of around 11%, Argentina and Brazil boast ratios comparable to those of many development nations – more than 30%. Other countries, including Bolivia, Honduras, Nicaragua, and Uruguay, have managed to collect tax ratios generally in line with expectations.

Inequality

In addition to the deficit in tax collection, another pending assignment is to generate tax systems that contribute meaningfully to addressing disparities in the region with the worst income inequality in the world. As Figure 1.4 shows, the wealthiest 10% of the income distribution concentrates 30% of income on average across countries in the region; by comparison, the average for the OECD is 24% of income. This concentration ranges from 40% of income in Brazil and 38% in Guatemala, on the higher end of the spectrum, to 20% in Uruguay and 23% in Venezuela, at the lower end. Conversely, the bottom 40% of the income distribution takes home 24% in Uruguay and 21% in Venezuela, compared to 15% in Brazil and 14% in Guatemala.

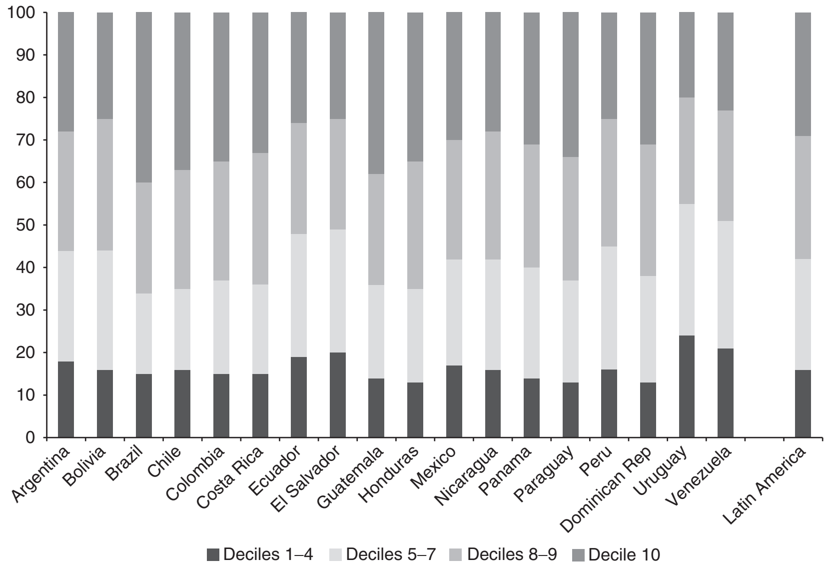

FIGURE 1.4 Latin America income share by decile group (%)
Source: Hanni et al. 2015, with data from ECLAC. Data ca. 2012

The region's inequality is problematic because, beyond moral considerations, inequality has negative consequences on growth and development. As Mahon Jr., Bergman, and Arnson (2015, 1) have pointed out, "Over the course of more than a generation of vibrant and mostly uninterrupted electoral democracy, Latin American governments have done almost nothing about the fact that the region suffers from the highest levels of inequality, on average, in the world."

In particular, there are two parts to the problem. First, fiscal redistribution is ineffective in Latin America in part because of the low levels of tax collection discussed earlier (Goñi et al. 2011, 1559). Second, most of the redistribution that does take place is conducted through transfers – particularly those in kind – rather than through taxes. The little that has been done corresponds mostly with efforts on the spending side, such as those related to conditional cash transfer programs – as with Brazil's Bolsa Família or Mexico's Progresa – or universal noncontributory pensions – as with Bolivia's Renta Dignidad or Mexico's Pensión Universal. On the taxation side, however, the region has been characterized by generally regressive tax systems that contribute little to addressing inequality and are a far cry from the highly redistributive European and even US systems (Mahon, Jr. 2012).

As Figure 1.5 shows, Latin American countries underperform considerably compared to their European counterparts – whose levels of market income inequality (46 versus 50) are not very different – regarding the redistributive effect of taxes. Although transfers play a more significant role in reducing inequality than taxes in some countries, the ability to carry out transfers hinges on the ability to collect taxes. Further, the effect of direct taxation in reducing inequality can be significant, as the European experience shows, but its potential has been unrealized in Latin America. Whereas in Europe income inequality measured as the Gini coefficient decreases by 5 points – from a gross income coefficient of 0.36 (after transfers) to a disposable income (after direct taxes) coefficient of 0.31, in Latin America the reduction amounts to one point – from 0.48 to 0.47. Although there is some variation across the region, from Mexico's reduction of 2.5 points at the high end to Paraguay's 0.3 points, the entire region stands to increase substantially the contribution of direct taxes to ameliorate inequality.

Clearly, there is a lot of room for improvement in leveraging tax collection to address inequality the way other countries do. Although the goal of increasing revenue has historically been pursued through indirect rather than direct taxes, there is increasing awareness that direct taxes can contribute to both increasing revenue and decreasing inequality.

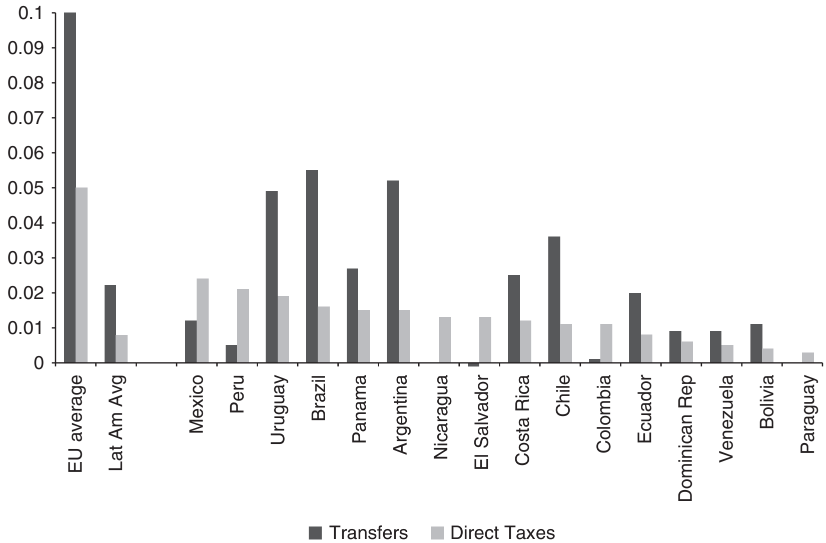

FIGURE 1.5 Change in inequality measured as Gini coefficient, *ca.* 2011
NB: Transfers correspond to changes from market income to gross income due to transfers and pensions. Direct taxes reflect changes from gross income to disposable income after direct taxes.
Sources: Data for Latin America from Hanni et al. 2015; Data for the European Union from Goñi et al. 2011

Indirect taxes have been considered a reasonable path to fiscal extraction in places where state capacity is low because they are comparatively easier to collect than direct taxes. They also have the advantage of not discouraging economic activity by reducing disposable income. Following this logic, reforms between the 1960s and early 1990s relied heavily on indirect taxes – first to fund rampant government spending and later to compensate for the foregone revenue from trade liberalization and the elimination of tariffs in the transition from an import-substitution development model to a free-market oriented one (Lora 2012; Mahon Jr. et al. 2015, 3).[4] Further, between the 1990s and mid-2000s taxes on income were simplified – under the argument that their progressivity discouraged economic activity in the form of labor supply and investment (Cornia et al. 2014, 295).

[4] For example, Brazil and Uruguay were early movers introducing the VAT in 1967 and 1968, respectively (Tanzi 2008).

As Figure 1.6 shows, on average, the vast majority of the gains in extraction during the 1990s took place due to indirect taxes – about 90% of total gains – with less than 10% of gains corresponding to taxes on income and profits (OECD 2016, 26). Today, Latin American levels of VAT collection are comparable to those of the OECD at about 7% of GDP (Gómez et al. 2014, 18).

However, indirect taxes tend to be regressive and therefore do little to address inequality. In fact, they make it worse. In Latin America, for example, after consumption taxes are subtracted from disposable income the Gini coefficient worsens by one point (Goñi et al. 2011, 1560). Consequently, beginning in the mid-2000s, some tax reforms have sought to pay attention to redistributive considerations, as in Uruguay in 2006 (Rius 2015), Mexico in 2013 (Romero 2015), Chile in 2014 (Fairfield 2015b), and Colombia in 2014 (Flores-Macías 2015). As Figure 1.6 shows, the gains have been considerably more balanced between 2000 and 2014, with gains on taxes on income and profits greater than those of VAT.

Still, in spite of these gains, the importance of income taxes in Latin America is considerably smaller than in other parts of the world. Whereas in developed economies in Europe and the United States income taxes are the largest contribution to tax revenue, indirect taxes are the main

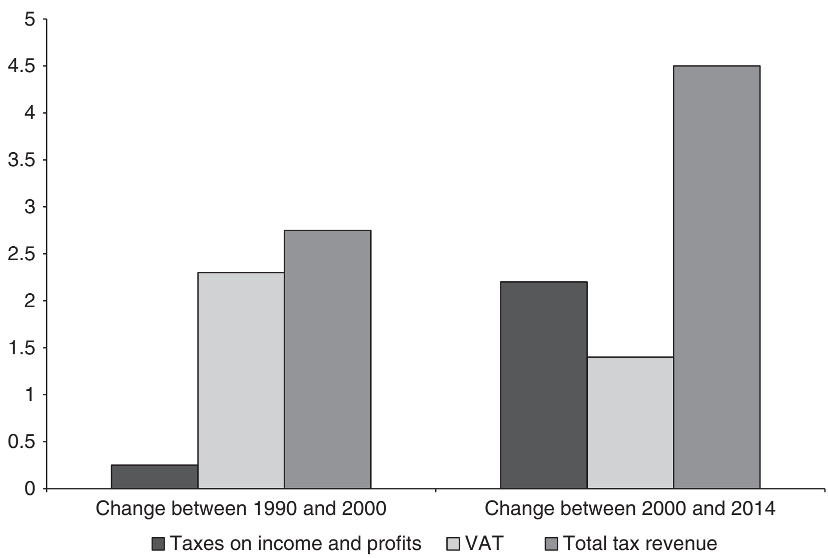

FIGURE 1.6 Change in total tax revenue (% of GDP)
Source: OECD 2016 ch. 1, fig. 1.3

generators of tax revenue in Latin America. Taxes on income and profits represent 12% of GDP on average for OECD countries – excluding Chile and Mexico – but only 6% in Latin America. Conversely, consumption taxes represent about 11% of GDP on average in both the OECD and Latin America (OECD 2016). In other words, whereas income taxes represented 27.8%, on average, of all tax revenue in Latin America, consumption taxes accounted for close to half (43%) (OECD 2016). While there is variation in personal income tax collection in Latin America – from Bolivia (0.20% of GDP) and Guatemala (0.5) at the low end of the spectrum, to Uruguay (3.4) and Brazil (3.6) at the high end (Mahon Jr. et al. 2015, 8) – the regional average lags behind Eastern Europe, Africa, and Asia, so there is ample room for the personal income tax to play a larger role.

BRINGING POLITICS BACK IN TO CONTRIBUTE TO REFORMS

The gloomy fiscal outlook for the region in the wake of the bust of the commodity bonanza has made addressing Latin America's pending fiscal assignments even more pressing. International organizations and scholars have called for the adoption of so-called second-generation reforms (Naím 1994; UN Economic Commission for Latin America 2014) – those aimed at addressing pending issues after the period of structural adjustment that preceded the commodity boom. In order to address the challenges of increasing extraction and reducing inequality, these reforms seek to increase efficiency, promote horizontal and vertical equity, reduce evasion, simplify the tax system, and eliminate loopholes (Gómez Sabaíni and Morán 2013; Ter-Minassian 2012).

Some of the technical ingredients for reform appear fairly straightforward. For example, if the objective is to strengthen countercyclical measures, the adoption of fiscal rules and the formation of autonomous fiscal councils that provide independent, more objective assessments of existing conditions, assumptions, and forecasts can go a long way. If the objective is to address inequality, higher progressivity should be adopted.

Other times, there is no agreement regarding how to accomplish a goal. In the case of collecting more in taxes, for example, the debate between those advocating raising marginal tax rates (Krugman 2012; Institute on Taxation and Economic Policy 2012) and those reducing them (Moore 2014) – i.e., whether there is any truth to the Laffer curve and where the inflection point might lie – remains unresolved.

Even when prescriptions are shared widely, successful implementation is easier said than done. As the literature on economic reforms has shown, even the best-designed policies are bound to fail when the political factors necessary for implementation are neglected (Haggard and Webb 1994; Haggard and Kaufman 1995). Compared to other economic reforms, research on the political determinants of fiscal extraction has taken a back seat, and important questions remain far from being resolved. At the most general level, for example, why and how are reforms successfully undertaken in some countries but not others? What is the role of factors such as public opinion, democratic institutions, natural resources, interest groups, ideology, and state capacity in hindering or facilitating fiscal extraction? Although recent efforts to address these issues in the Latin American context are encouraging (e.g., Arce and Wibbels 2003; Castañeda 2017; Fairfield 2015a; Fairfield and Garay 2017; Focanti et al. 2013; Mahon Jr. et al. 2015; Ondetti 2017; 2015; Sánchez 2011; Schneider 2012), many of these topics are only beginning to receive the attention they deserve. To be sure, many of the claims about the political factors affecting taxation still await a first evaluation or a systematic discussion in the Latin American context.

The lack of understanding of these topics has impaired our ability to improve tax systems. This does not mean that tax reforms do not take place in the region. Quite the opposite: in many countries they take place fairly often, as Hallerberg and Scartascini (Chapter 6 in this volume) show. In places such as Colombia or Mexico, they might even take place every handful of years. However, without knowledge of the political factors that might be conducive to reform, reforms often end up being fairly cosmetic because of the difficulty of overcoming political obstacles. In spite of the frequency of reforms, Mexico's tax intake as a share of GDP has consistently hovered around 10% of GDP over the last fifty years (Tello and Hernández 2010; Ondetti, Chapter 4 in this volume). Other times, they might even turn out to be detrimental to a reform's original objectives.

Given these impediments, this volume seeks to improve our understanding of the different avenues through which reform may become possible. These include the study of structural aspects – from historical legacies to resource dependence – that have made reforms difficult and are worth taking into account when designing strategies for reform. Other less permanent factors, such as levels of state capacity and compliance, institutional arrangements, and electoral cycles, are also important in shaping strategies for reform and the likelihood for success. Finally, the study of interest groups, business–government relations, and public opinion at the mass level can play a key role in facilitating tax reform.

For example, the expansion of income taxes has tended to face important political obstacles. Although this course of action makes sense in highly unequal societies because of the taxes' progressivity, inequality is also what makes its adoption difficult in practice (Agosín et al. 2008). In countries where wealth tends to be highly concentrated, the taxpayer base tends to be fairly narrow. Governments have to rely on this narrow base for increases in income taxes, but these sectors begrudge having to carry the weight of the fiscal burden. Moreover, the wealthiest sectors are also those best able to avoid additional tax obligations through lobbying or finding loopholes in the tax code (Castañeda 2017; Fairfield, Chapter 7 in this volume; Moore 2013).

The difficulty in expanding income taxes and making them progressive is not new; it has been current for decades, and not because of lack of technical expertise. During the 1950s and 1960s, in the context of the Alliance for Progress, the United States, the Organization of American States, the Inter-American Development Bank, and the United Nations promoted the expansion of income taxes, but governments were reluctant to rely on them meaningfully because of political obstacles and electoral considerations (Tanzi 2008).

More recently, explanations for the low productivity of income taxes have ranged from the high share of informal sector that characterizes Latin American countries – at more than 50% in some countries – to the weakness of tax administrations in collecting revenue that is not withheld at the source (Bergman, Chapter 3 this volume; Tanzi 2008). Indeed, the share of total income that corresponds to nonwage income is fairly high in the region. Wage income is less than 30% in some places – as in Mexico, with 28% – compared to 70% in some industrialized countries (Tanzi 2008, 8). How to tax adequately salaried workers, and especially how to tax the large majority whose income is not withheld at the source, remains a significant challenge.

The animosity toward expanding the tax base and increasing the progressivity of the tax system can be especially strong in resource rich countries. In places where natural resources are available, resource wealth often generates perceptions of wealth among the population, undermining efforts to increase the tax burden because of the expectation that the government will fund its expenditures through taxes on natural resource extraction and royalties, especially if these companies are foreign (Tanzi 2008). The result is that resource-dependent countries tend to engage in procyclical policies, spending in the boom and retracting during the bust.

Electoral politics also makes the adoption of meaningful reforms difficult. Campaign season reduces incentives for incumbents to introduce reforms deemed unpopular among the general population or among financial patrons of political campaigns. The incentive is for incumbents not to formulate any reform initiatives, or, if they do, to formulate them in ways that dilute any real fiscal impact because of fear of retaliation on election day.

Beyond elections, shaping public opinion more generally is another important challenge behind the adoption of reforms. Due to the unpopularity of taxation, convincing people to pay more in taxes is difficult (Mahon Jr. et al. 2015). Additionally, because of the extreme inequality that exists in Latin America, economic elites resent the narrow basis for fiscal extraction and look to incorporate broad sectors of society into sharing the tax burden. Conversely, the general public looks to the wealthy to shoulder more in taxes. Both sectors begrudge being targeted whenever the government looks for additional revenue.

As a result, not only are citizens generally opposed to increases in the tax burden, but many will also go out of their way to circumvent their tax obligations (Prichard 2016). Latin American countries' tax compliance tends to be lower than in other parts of the world (Bergman 2009). Compliance at times has to do with attitudes and practices that persist in society. At other times, compliance is a function of willingness to enforce regulations based on political considerations. Yet others, it is contingent on the state's capacity to enforce such tax laws. It is important to take into account these considerations when devising strategies to make the adoption of reforms feasible and their sustainability possible.

ORGANIZATION OF THE BOOK

This book is intended to address several gaps in the literature on the political economy of taxation in Latin America. In particular, it provides a big-picture perspective of the relationship between taxation and the key actors and forces in Latin America based on topics that generally cut across countries and areas of interest to the entire region. Chapters studying mainly levels of taxation are presented first, followed by those focusing mainly on progressivity in the tax structure, although the emphasis is often shared.

In Chapter 2, Francisco Monaldi studies the determinants of tax policy related to hydrocarbons. It answers the question of why some countries increase the fiscal intake through greater state intervention during commodity booms, while others reduce government control over the industry and turn to the private sector. In particular, it points to the role that certain characteristics of the oil sector – including rents, sunk costs, and the risk profile of a project – along with geological endowments and the price and investment cycles play in determining tax policy in the hydrocarbons sector.

Marcelo Bergman (Chapter 3) focuses on tax compliance in the region and points to a recent paradox. Typically, gains in compliance take place when economies are growing, since taxpayers are less inclined to rely on evasion during good times. However, although Latin America recently enjoyed one of its most prosperous decades since WWII, tax compliance remained fairly stable at mediocre levels. Based on several indirect measures of compliance, this chapter both identifies this pattern and evaluates potential explanations. It suggests that a combination of commodity boom benefits, political variables, and cultural factors account for the lack of improvement of tax compliance rates.

Gabriel Ondetti (Chapter 4) offers insight into the question of why there is so much variation in levels of fiscal extraction across the region. Recognizing that natural resources can only go so far in explaining this variation, he points to the historical legacies of early redistributive attempts as a key factor in understanding why countries have experienced different tax burdens over time. Based on a comparison of Brazil, Chile, and Mexico, he points to early reforms that gave rise to an enduring antistate ideology among key sectors of the economic elites in Chile and Mexico, which was institutionalized in important political organizations and became an impediment to the heavier taxation observed in Brazil.

Aaron Schneider (Chapter 5) focuses on the relationship between taxation and patterns of economic incorporation. Based on a historical overview of the Brazilian case, it shows that the country's ability to extract more in taxes than any other country in the region, and as much as some developed countries, has not always been the case. The chapter suggests that variation over time is due in part to the nature of the interaction between the type of developmental model and federalism. The adoption of different federal arrangements that accommodated the shifting fortunes of rising and falling elite and popular sectors – associated with new patterns of international insertion – explain variation in that country's level of taxation over time.

Mark Hallerberg and Carlos Scartascini (Chapter 6) explore the determinants of tax reforms in the region. In particular, they examine whether the electoral rules that bring legislators to office – determining how "personal" or narrow a constituency elects them – shape the neutrality of reforms. They find that legislatures with rules favoring narrow constituencies favor reforms that compromise the neutrality of the tax system. They also find a diffusion effect: reforms affecting the neutrality in the system are more likely to take place following those adopted by other countries in the region.

Tasha Fairfield's chapter (Chapter 7) also contributes to our understanding of both extracting fiscal revenue and addressing inequality. Contrary to traditional median-voter approaches (Meltzer and Richard 1981; Boix 2003; Acemoglu and Robinson 2006), she finds that economic elites play a central role in the politics of tax policy. Instead, her chapter highlights the role of the business sector's instrumental and structural power as a central component in explaining why economic elites' wealth has been targeted in some countries but not others. Drawing on evidence from experiences in Argentina, Bolivia, and Chile, she finds that efforts at elite taxation are least successful when either instrumental or structural power is strong, especially institutionalized partisan linkages in the former and organizational robustness in the latter.

James Mahon, Jr. (Chapter 8) advances our understanding of how to make tax systems more progressive by exploring the role of property and income taxes in the liberal tradition. Placing experiences in the region in a global and historical perspective, the chapter focuses not only on revenue generation, but also on the control and programmatic orientation of spending. It finds that Latin America's low reliance on property taxes is consistent with a fiscal-contract notion in which a relative weakness in personal income and property taxation corresponds to a similar weakness in policy outcomes.

Juan Bogliaccini and Juan Pablo Luna (Chapter 9) explore preferences on taxation and redistribution in Latin America. Their analysis identifies variation across the region in the degree to which preferences for progressive taxation are consistent with individuals' political ideology, economic well-being, and class. Drawing on survey research from ten Latin American countries, they find that there is strong support for progressive taxation across the region. However, with the exception of Guatemala and Mexico, in most Latin American countries political ideology, perceptions of economic well-being, and class are not determinants of attitudes toward progressive taxation.

The concluding chapter addresses the volume's findings and discusses their potential impact for the region. In particular, it discusses their implications for levels of taxation and the nature of the tax structure. It suggests that several of the factors covered in this volume can play an important role in making the adoption of fiscal reforms more likely and sustainable over time. The Conclusion also discusses the tension between path dependence and the role of ideology, as well as between elites and the public for taxation. Finally, the Conclusion offers potential avenues for future research.

References

Acemoglu, Daron, and James Robinson. 2006. *Economic Origins of Dictatorship and Democracy*. New York: Cambridge University Press

Agosín, Manuel, Alberto Machado, and Aaron Snyder. 2008. "The Struggle for Tax Reform in Central America," in Diego Sánchez-Ancochea and Iwan Morgan (eds.), *Political Economy of the Public Budget in the Americas*, London: Institute for the Study of the Americas.

Arce, Moises and Erik Wibbels. 2003. "Globalization, Taxation, and Burden-Shifting in Latin America," *International Organization* 57 (1): 111–136.

Ardanaz, Martín, Ana Corbacho, Alberto Gonzales, and Nuria Tolsa Caballero. 2015. "Structural Fiscal Balances in Latin America and the Caribbean: New Dataset and Estimations," *IDB Working Paper Series* 579, Washington, DC: Inter-American Development Bank.

BBC. 2016. "India Outpaces China in 2015 Economic Growth," *BBC Online*, February 8: www.bbc.com/news/business-35519671.

Bergman, Marcelo. 2009. *Tax Evasion and the Rule of Law in Latin America*. University Park: Penn State University Press.

Bird, Richard. 2012. "Taxation and Development: What Have We Learned from Fifty Years of Research?" Working Paper 1, International Center for Tax and Development, UK.

Boix, Carles. 2003. *Democracy and Redistribution*. New York: Cambridge University Press.

Brautigam, Deborah, Odd-Helge Fjeldstad, and Mick Moore (eds.). 2008. *Taxation and State-Building in Developing Countries*. New York: Cambridge University Press.

Buchanan, James. 1963. "The Economics of Earmarked Taxes," *Journal of Political Economy* 71 (5): 457–469.

Caceres, Carlos and Bertrand Gruss. 2015. "The Commodity Price Bust: Fiscal and External Implications for Latin America," in International Monetary Fund, in *Regional Economic Outlook: Western Hemisphere*, Washington, DC: IMF: 43–53.

CAF Banco de Desarrollo de América Latina. 2012. *Finanzas públicas para el desarrollo: fortaleciendo la conexión entre ingresos y gastos*. Bogotá: Panamericana Formas e Impresos.

Canavire-Bacarreza, Gustavo, Jorge Martínez-Vázquez, and Violeta Vulovic. 2013. "Taxation and Economic Growth in Latin America," *IDB Working Paper Series* 431, Washington, DC: Inter-American Development Bank.

Castañeda, Néstor. 2017. "Business Coordination and Tax Politics," *Political Studies* 65 (1): 122–143.

Centro de Estudios Sociales y de Opinión Pública. 2013. *Encuesta telefónica acerca de la reforma hacendaria*. Mexico: CESOP.

Cornia, Giovanni Andrea, Juan Carlos Gómez-Sabaíni, and Bruno Martorano. 2014. "Tax Policy and Income Distribution during the Last Decade," in Giovanni Andrea Cornia (ed.), *Falling Inequality in Latin America: Policy Changes and Lessons*. Oxford: Oxford University Press, 295–317.

Council of Foreign Relations. 2014. "Mexico's Oil and Taxes," CFR Latin America's Moment Blog: www.cfr.org/blog/mexicos-oil-and-taxes.

De Ferranti, David, Guillermo Perry, Francisco Ferreira, and Michael Walton. 2004. *Inequality in Latin America: Breaking with History?* Washington, DC: The World Bank.

Evans, Peter. 1995. *Embedded Autonomy: States and Industrial Transformation*. Princeton: Princeton University Press.

Fairfield, Tasha. 2015a. *Private Wealth and Public Revenue: Business Power and Tax Politics in Latin America*. New York: Cambridge University Press.

2015b. "The Political Economy of Progressive Tax Reform in Chile," in Mahon Jr., Bergman, and Arnson (eds.), *The Political Economy of Progressive Tax Reforms in Latin America*, Washington, DC: Woodrow Wilson Center, 30–56.

Fairfield, Tasha and Candaleria Garay. 2017. "Redistribution under the Right in Latin America: Electoral Competition and Organized Actors in Policy Making," *Comparative Political Studies* 50 (14): 1871–1906.

Flores-Macías, Gustavo. 2015. "The Political Economy of Colombia's 2012 and 2014 Fiscal Reforms," in Mahon Jr., Bergman, and Arnson (eds.), *The Political Economy of Progressive Tax Reforms in Latin America*. Washington, DC: Woodrow Wilson Center, 101–126.

2016. "Mexico's Stalled Reforms," *Journal of Democracy* 27 (2): 66–78

2018. "Building Support for Taxation in Developing Countries: Experimental Evidence from Mexico," *World Development* 105: 13–24.

Focanti, Diego, Mark Hallerberg, and Carlos Scartascini. 2013. "Tax reforms in Latin America in an era of democracy," *IDB Working Paper Series* 457, Washington, DC: Inter-American Development Bank.

Fuentes Knight, Juan Alberto. 2012. *Rendición de Cuentas*. Guatemala: F&G Editores.

Fundación Jaime Guzmán. 2011. *Encuesta sobre la reforma tributaria: Agosto 2011*. Chile: FJG.

Goetz, Charles. 1968. "Earmarked Taxes and Majority Rule Budgetary Processes," *American Economic Review* 58 (March): 128–136.

Gómez Sabaíni, Juan Carlos and Dalmiro Morán. 2013. *Política tributaria en America Latina: Agenda para una segunda generación de reformas*. Comisión Económica Para América Latina. Chile: Naciones Unidas.

Goñi, Edwin, Humberto López, and Luis Servén. 2011. "Fiscal Redistribution and Income Inequality in Latin America," *World Development* 39 (9): 1564–1566.
Graham, Dave. 2017. "Mexico to Slow Pace of Budget Cuts in 2018: Finance Minister," *Reuters*, June 20.
Haggard, Stephan and Robert Kaufman. 1995. *The Political Economy of Democratic Transitions*. Princeton: Princeton University Press.
Haggard, Stephan and Steven Webb (eds.). 1994. *Voting for Reform*. New York: Oxford University Press.
Hanni, Michael, Ricardo Mdartner, and Andrea Podestá. 2015. "The Redistributive Potential of Taxation in Latin America," *CEPAL Review* 116 (August): 7–26.
Hsu, Sara. 2017. "China's GDP Numbers: Can We Trust the Data?" Forbes, Jan 23.
Inter-American Development Bank. 2013. *More than Revenue: Taxation as a Development Tool*. Washington, DC: IADB.
IMF. 2015. *Fiscal Policy in Latin America: Lessons and Legacies of the Global Financial Crisis*. Washington, DC: IMF.
Institute on Taxation and Economic Policy. 2012. "*High Rate Income Tax Rates Are Outperforming No-Tax States*," ITEP: Washington, DC, February: https://itep.org/wp-content/uploads/junkeconomics.pdf.
Krugman, Paul. 2012. "More Laffering," New York Times, May 25.
Lajous, Adrián. 2014. *Mexican Energy Reform*, Center on Global Energy Policy, New York: Columbia University: https://energypolicy.columbia.edu/sites/default/files/CGEP_Adrian%20Lajous_Mexican%20Energy%20Reform_Final.pdf.
Lora, Eduardo. 2012. "Structural Reforms in Latin America: What Has Been Reformed and How to Measure It." IADB Working Paper 346. Washington, DC: Inter-American Development Bank.
Magnier, Mark. 2016. "China's Economic Growth in 2015 Is the Slowest in 25 Years," *Wall Street Journal*, January 19.
Mahon, Jr., James. 2012. "Tax Incidence and Tax Reforms in Latin America," Woodrow Wilson Center Update on the Americas, November: www.wilsoncenter.org/sites/default/files/WWC_LAP_MahonReport.pdf.
Mahon, Jr., James, Marcelo Bergman, and Cynthia Arnson. 2015. "The Political Economy of Progressive Tax Reform in Latin America: Comparative Context and Policy Debates," in Mahon Jr., Bergman, and Arnson (eds.), *The Political Economy of Progressive Tax Reforms in Latin America*, Washington, DC: Woodrow Wilson Center, 1–29.
Meltzer, Allan and Scott Richard. 1981. "A Rational Theory of the Size of Government," *Journal of Political Economy* 89, 5 (October): 914–927.
Monaldi, Francisco. 2014. *Is Resource Nationalism Fading in Latin America? The Case of the Oil Industry*, Baker Institute Issue Brief, September 3.
Moore, Mick. 2013. "Obstacles to Increasing Tax Revenue in Low Income Countries," ICTD Working Paper 15, International Center for Tax and Development.
Moore, Stephen. 2014. "The Laffer Curve Turns 40: The Legacy of a Controversial Idea," *Washington Post*, December 26.

Naím, Moises. 1994. "Latin America: The Second Stage of Reforms," *Journal of Democracy* 5 (4): 32–48.

OECD. 2016. *Revenue Statistics in Latin America and the Caribbean 2016*. Paris: OECD.

Ondetti, Gabriel. 2015. "The Roots of Brazil's Heavy Taxation," *Journal of Latin American Studies* 47 (4): 749–779.

2017. "The Power of Preferences: Economic Elites and Light Taxation in Mexico," *Revista Mexicana de Ciencias Políticas y Sociales* 62 (231): 47–76.

Organization of Economic Cooperation and Development. 2018. Revenue Statistics (Online Resource): www.oecd.org/tax/tax-policy/revenue-statistics-2522770x.htm

Paler, Laura. 2013. "Keeping the Public Purse: An Experiment in Windfalls, Taxes, and the Incentives to Restrain Government," *American Political Science Review* 107 (4): 706–725

Paraguassu, Lisandra and Maria Carolina Marcello. 2017. "Brazil Senate Leader sees 30 Billion – 35 Billion Reais Spending Freeze," *Reuters,* March 21.

Paraskova, Tsvetana. 2018. "The Revival of Mexico's Oil Industry," *Oilprice.com*, January 25.

Prichard, Wilson. 2016. "Reassessing Tax and Development Research: A New Dataset, New Findings, and Lessons for Research," *World Development* 80 (4): 48–60.

Prichard, Wilson and Mick Moore. 2018. "Tax Reform for Low-Income Countries: Five Ideas for Simplifying Tax Systems to Fit Local Realities," Summary Brief 17, International Center for Tax and Development.

Riffkin, Rebecca. 2014. "More Than Half of Americans Say Federal Taxes Too High," Gallup Online, April 14. Available at www.gallup.com/poll/168500/half-americans-say-federal-taxes-high.aspx

Rius, Andrés. 2015. "The Uruguayan Tax Reform of 2006: Why Didn't It Fail?" in Mahon Jr., Bergman, and Arnson (eds.), *The Political Economy of Progressive Tax Reforms in Latin America*, Washington, DC: Woodrow Wilson Center, 64–100.

Romero, Vidal. 2015. "The Political Economy of Progressive Tax Reforms in Mexico," in Mahon Jr., Bergman, and Arnson (eds.), *The Political Economy of Progressive Tax Reforms in Latin America*, Washington, DC: Woodrow Wilson Center, 161–188.

Santos de Souza, Saulo. 2013. "The Political Economy of Tax Reform in Latin America: A Critical Review," *Woodrow Wilson Center Update on the Americas*, February.

Sánchez, Omar. 2011. *Mobilizing Resources in Latin America: the Political Economy of Tax Reform in Chile and Argentina*. New York: Palgrave Macmillan.

Schipani, Andrés. 2015. "Oil fall shuts Colombia's 'Door to Paradise,'" *Financial Times*, August 7.

Schneider, Aaron. 2012. *State-Building and Tax Regimes in Central America*. New York: Cambridge University Press.

Tanzi, Vito. 2008. "Introduction," in Luigi Bernardi, Alberto Barreix, Anna Marenzi, and Paola Profeta (eds.), *Tax Systems and Tax Reforms in Latin America*. New York: Routledge: 1–16.

Ter-Minassian, Teresa. 2012. "More than Revenue: Main Challenges for Taxation in Latin America and the Caribbean," *IDB Policy Brief* 175, Washington, DC: Inter-American Development Bank.
Tello, Carlos and Domingo Hernández. 2010. "Sobre la Reforma Tributaria en México," *Economía* 7 (21): 37–56.
Tilly, Charles. 2009. "Foreword," in Isaac William Martin, Ajay K. Mehrotra, and Monica Prasad (eds.), *The New Fiscal Sociology: Taxation in Comparative and Historical Perspective*, New York: Cambridge University Press, xi–xiv.
Times of India. 2017. "India's GDP Growth to Fall at 7.1% in 2016–17, Estimates Government," January 7.
UN Economic Commission for Latin America. 2014. *Tax Policy in Latin America: Assessments and Guidelines for a Second Generation of Reforms*. Chile: CEPAL.
UN Economic Commission for Latin America and the Caribbean (UNECLAC). 2018. CEPALSTAT (Online Resource): http://estadisticas.cepal.org/cepalstat/portada.html?idioma=english
Wagner Faegri, Cristina and Carol Wise. 2011. "Economic and Fiscal Policy in Latin America," Latin American *Research Review* 46 (1): 240–250.
Willis, Andrew. 2015. "Colombia Oil Target Seen Slumping below Target as Wells Drop," *Bloomberg Online*, November 10.
World Bank. 2016. *The Commodity Cycle in Latin America: Mirages and Dilemmas*, Washington, DC: The World Bank.
2018. *World Development Indicators* (Online Resource): https://data.worldbank.org
Zhang, Hongrui. 2016. "Gauging Latin America's Dependence on Commodities," *BTMU Focus Latin America*, January 5.
Zuckman, Gabriel. 2015. *The Hidden Wealth of Nations*. Chicago: University of Chicago Press.