

Personal Income Tax and Equity in Latin America: New Challenges

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UNITED NATIONS

INTERNATIONAL TAX DIALOGUE
Global Conference on Tax and Inequality

ECLAC

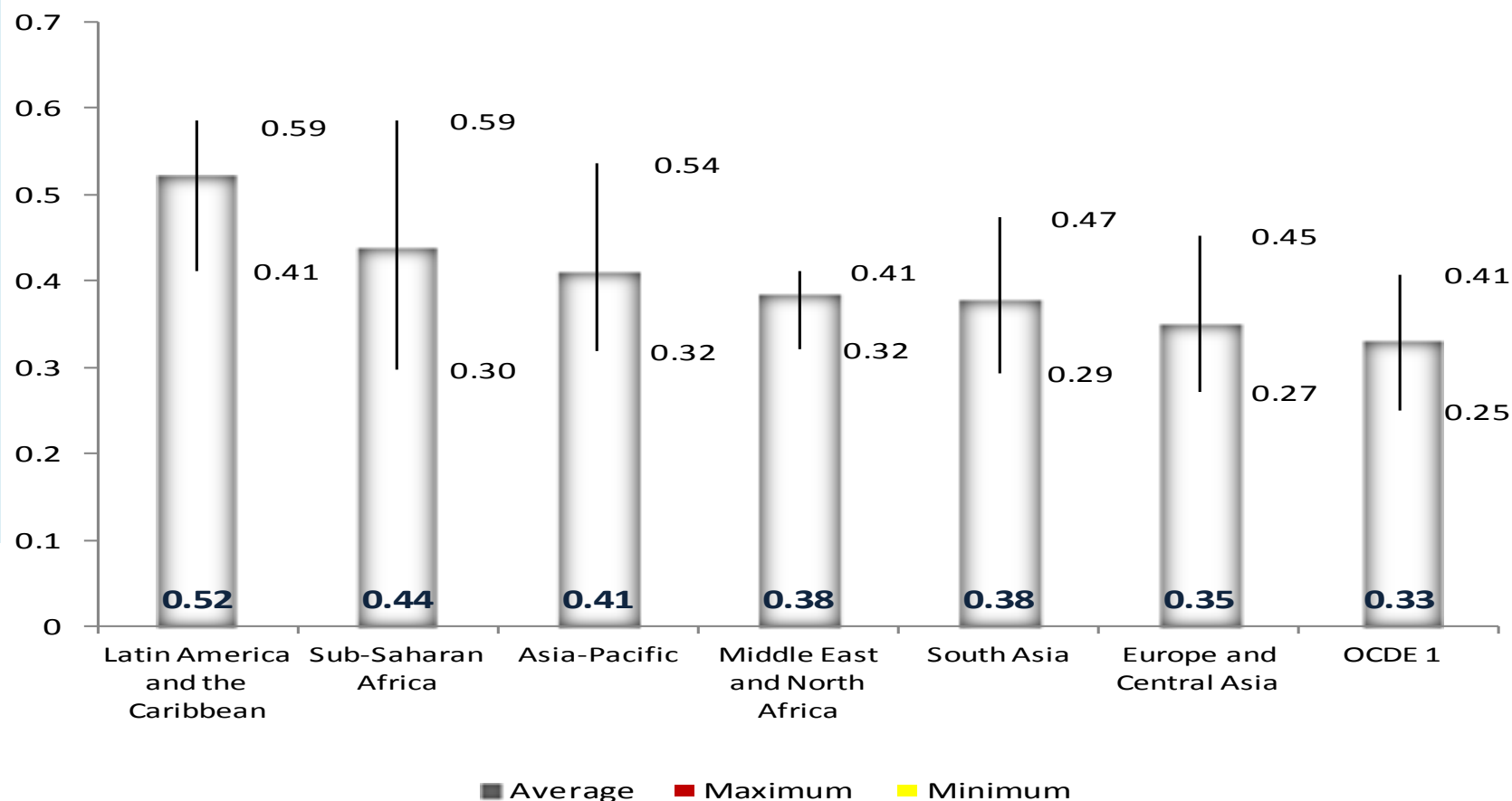
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Overview

- I. Characteristics of inequality in Latin America**
- II. The role of fiscal policy in the income distribution**
- III. Potentiality of the PIT as an instrument to improve income distribution**
- IV. Conclusions**

Latin America is the most unequal region in the world

GINI INDEX BY GROUP OF COUNTRIES, LAST DATA AVAILABLE



Characteristics of inequality in LA

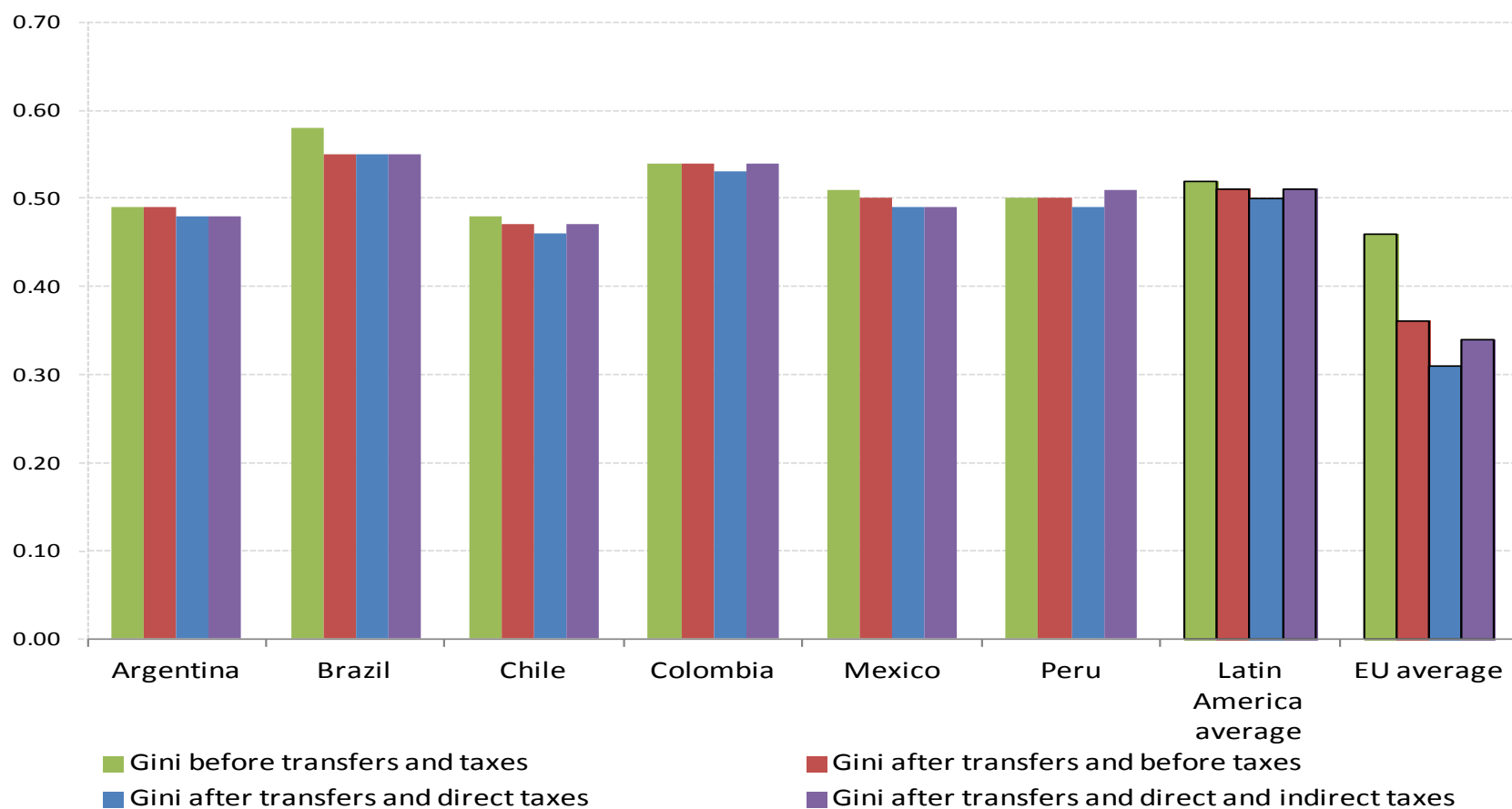
- High inequality in the distribution with a high concentration of income in the richest decile
- Significant differences within the country jurisdictions (geographical inequality)
- High levels of poverty and destitution
- Large size of the informal economy

The role of fiscal policy in the income distribution

- It seems that fiscal policy impact on income distribution in the region has been quite low when compared with developed countries
- And done mainly through the expenditure side

The redistributive capacity of fiscal policy is lower than in developed countries

LATIN AMERICA AND EU COUNTRIES: DISTRIBUTIVE IMPACT OF FISCAL POLICY
(Gini Index)



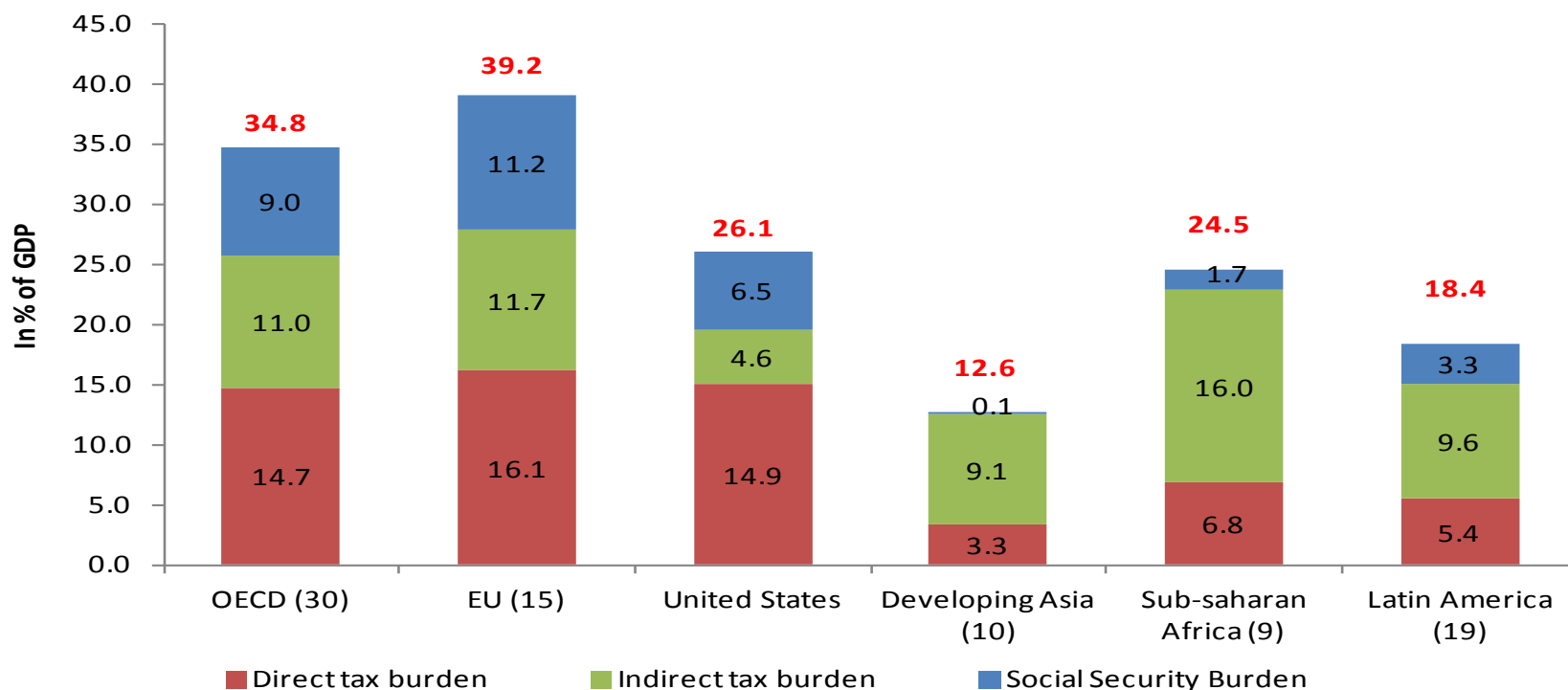
Source: Goñi, E., J.H. López and L. Servén (2011), "Fiscal redistribution and income inequality in Latin America", The World Bank.

The role of fiscal policy in the income distribution

- Through public expenditure, mainly social public expenditure
- Through its financing: tax policy
 - Level and structure

However, average tax burden in Latin America is still low when compared with other regions

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).

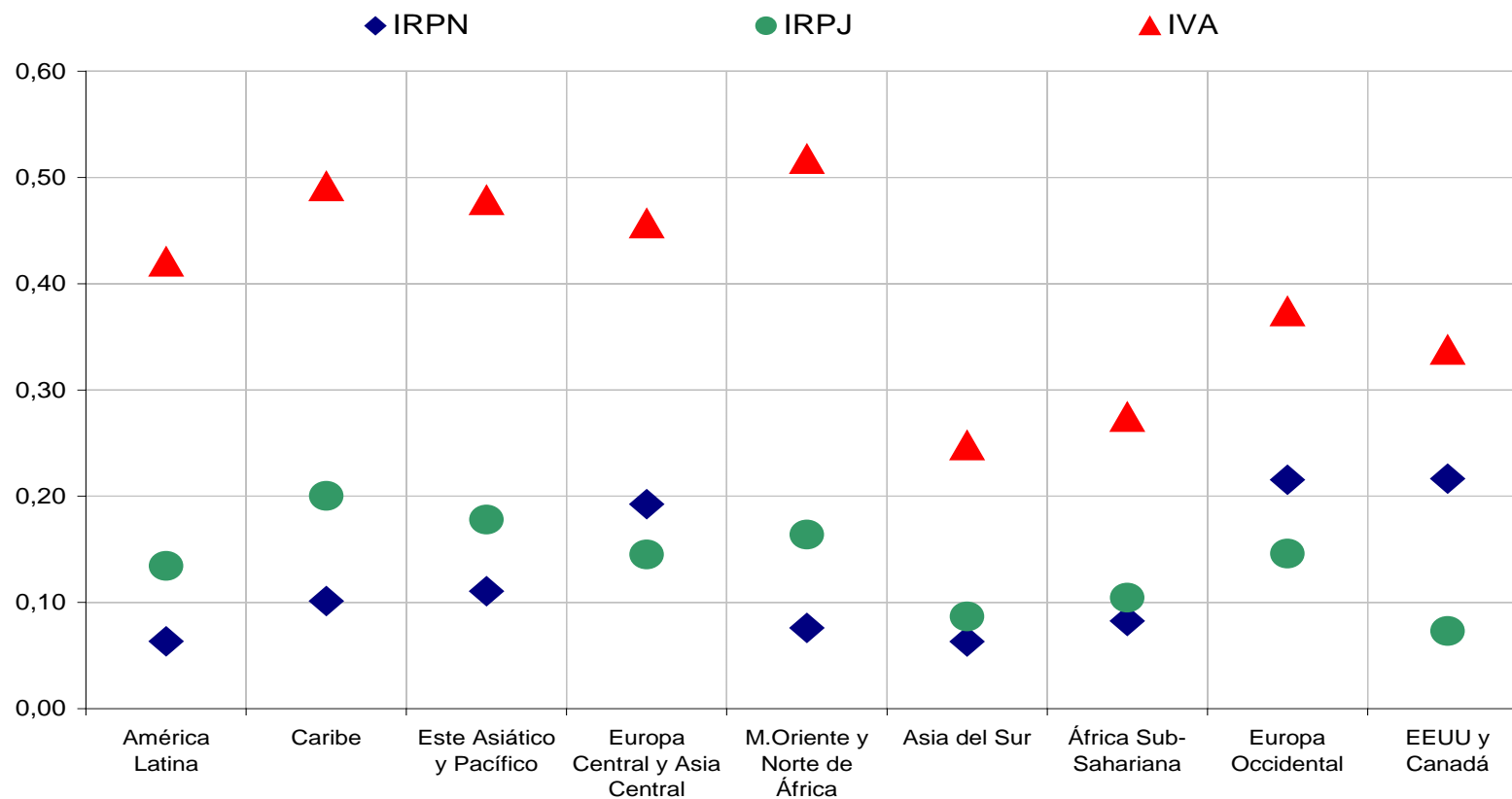
Income tax collected, on average, more than double in OECD countries than in Latin America

AVERAGE INCOME TAX STRUCTURE IN LATIN AMERICA AND OECD – year 2009

	IRPJ	IRPN	IR Total	IRPJ	IRPN	IR Total	IRPJ / IRPN
	(en % del PIB)			(en % del total recaudado)			ratio
América Latina	3,4	1,6	5,0	19,0	8,5	27,5	2,2
OECD	3,6	8,9	12,5	10,2	25,4	35,6	0,4

Comparing with other regions...

AVERAGE PRODUCTIVITY OF THE INCOME TAX AND THE VAT – YEAR 2009



Source: Own elaboration based in ECLAC (tax collection) and USAID Fiscal Reform and Economic Governance, Collecting Taxes 2009-10 (legal tax rates).

The potentiality of PIT as an instrument to improve income distribution in Latin America

- **Distributive incidence in Latin America**
- **Limiting factors affecting the redistributive impact of PIT in Latin America**
 - **Reduced tax rates**
 - **Narrow tax bases**
 - **High level of non-compliance**

The Personal Income Tax has a “progressive design” but low impact on income redistribution

DISTRIBUTIVE IMPACT OF THE PERSONAL INCOME TAX IN LATIN AMERICA

País	Año	INDICES					Quién paga el impuesto		
		Gini pre impuestos	Cuasi Gini impuestos	Kakwani	Gini post impuestos	Reynolds Smolensky	40% inferior	20% superior	20% sup. / 40% inf.
Colombia	2004	0.5370	0.8940	0.3570	0.4590	0.0780	0%	99%	497.0
Rep.Dominicana	2004	0.5106	0.9057	0.3951	0.4759	0.0347	0%	97%	-
Chile	2006	0.5791	0.9677	0.3886	0.5584	0.0207	0%	99%	-
Uruguay	2006	0.4995	0.8630	0.3635	0.4875	0.0120	0%	92%	230.3
Argentina	2006	0.4839	0.9375	0.4536	0.4738	0.0101	0%	98%	-
El Salvador	2006	0.5034	0.8281	0.3247	0.4947	0.0087	1%	90%	90.0
Costa Rica	2004	0.5770	0.9098	0.3328	0.5692	0.0078	0%	96%	874.6
Brasil	2003	0.6180	0.9243	0.3063	0.6119	0.0061	1%	94%	156.7
Nicaragua	2001	0.5963	0.9441	0.3478	0.5905	0.0058	0%	94%	-
Panamá	2003	0.6364	0.8803	0.2439	0.6312	0.0052	2%	96%	54.0
Honduras	2005	0.5697	0.9000	0.3303	0.5647	0.0050	0%	95%	-
Ecuador	2004	0.4080	0.8310	0.4230	0.4040	0.0040	0%	93%	311.0
Venezuela	2004	0.4230	0.8400	0.4170	0.4210	0.0020	0%	100%	-
Guatemala	2000	0.5957	0.9115	0.3158	0.5946	0.0011	2%	93%	48.8
Perú	2004	0.5350	0.5820	0.0470	0.5344	0.0007	10%	64%	6.7

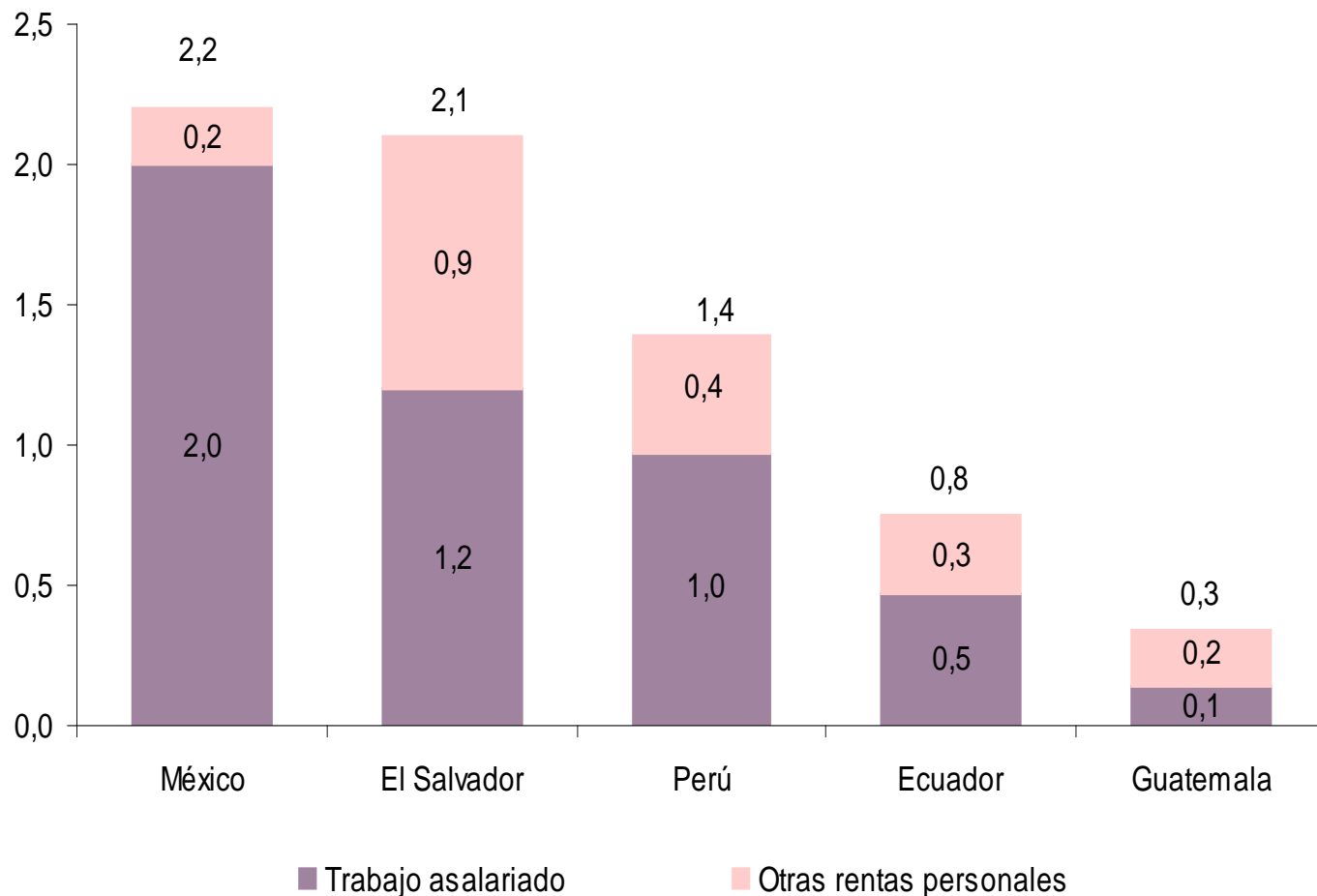
Source: Barreix, A., Bès, M. and Roca, J. (2009); Barreix, A., Roca, J. and Villela, L. (2006); Gómez Sabaini, J.C.; Harriague, M. yand Rossignolo, D. (2011); Rezende, F. and Afonso, J. (2010); Roca, J. (2010); and Jorrat, M. (2010)

The potentiality of PIT as an instrument to improve income distribution in Latin America

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 - **Reduced tax rates**
 - **Narrow tax bases**
 - **High level of non-compliance**

The PIT is mainly based in wage-related rents leaving aside capital gains

**SELECTED COUNTRIES:
STRUCTURE OF THE PERSONAL INCOME TAX, 2007**
(Percentage of GDP)



The minimum and the maximum tax rates apply differently than in other regions

**TAXABLE INCOME (as a percentage of per capita GDP) AND STATURORY TAXES (in percentages)
THE PERSONAL INCOME TAX IN LATIN AMERICA AND OTHER REGIONS – YEAR 2009**

Regions	PIT Taxable Income (a)		Shares (in percentages)		
	Minimum	Maximum	PIT (minimum)	PIT (maximum)	CIT
Latin America (18)	1.52	10.27	10.60	27.10	26.80
Caribbean (17)	1.47	5.99	17.50	32.10	31.10
East Asia and Pacific (32)	1.19	15.65	9.00	29.00	24.00
Central Europe and Central Asia (31)	1.08	2.16	13.30	19.40	15.80
Middle East and North Africa (21)	1.21	8.60	10.40	26.00	24.90
South Asia (8)	3.22	34.17	8.60	25.70	30.40
Sub-saharan Africa (47)	2.55	19.11	10.10	35.20	30.30
Western Europe (20)	0.35	3.97	16.70	39.90	26.10
United States and Canada (2)	0.20	5.42	12.50	32.00	26.50

Source: Own elaboration based in USAID Collecting Taxes 2009-10 database

And high tax expenditures reduce the tax bases

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Tax non-compliance is higher in the Income Tax than in the VAT

ESTIMATED TAX GAP IN THE VAT AND IT

VAT			INCOME TAX			
	Estimated tax gap rate	Year	Estimated tax gap rate			Year
			Total	Individuals	Companies	
Argentina	21.2%	2006	49.7%	--	--	2005
Bolivia	29.0%	2004	--	--	--	--
Chile	11.0%	2005	47.4%	46.0%	48.4%	2003
Costa Rica	28.7%	2002	--	--	--	--
Colombia	23.5%	2006	--	--	--	--
Ecuador	21.2%	2001	63.8%	58.1%	65.3%	2005
El Salvador	27.8%	2006	45.3%	36.3%	51.0%	2005
Guatemala	37.5%	2006	63.7%	69.9%	62.8%	2006
Mexico	20.0%	2006	41.6%	38.0%	46.2%	2004
Nicaragua	38.1%	2006	--	--	--	--
Panamá	33.8%	2006	--	--	--	--
Peru	37.7%		48.5%	32.6%	51.3%	2006
Dominican Rep.	31.2%	2006	--	--	--	--
Uruguay	26.3%	2006	--	--	--	--

Source: Own elaboration based in official information for VAT and Jiménez, J.P. et al. (2010) "Tax gap and equity in Latin America and the Caribbean" for the Income Tax (ECLAC-GTZ).

Conclusions

- The lack of an adequate PIT has an important distributional cost in LA.
- PIT can be increased in the region.
- Three central pillars should be exploited conveniently in the future tax reforms:
 - The equalization of marginal tax rates to international levels,
 - Expanding the tax base, reaching capital gains and eliminating excessive tax expenditures and,
 - Improvements in tax compliance.

Thank you!

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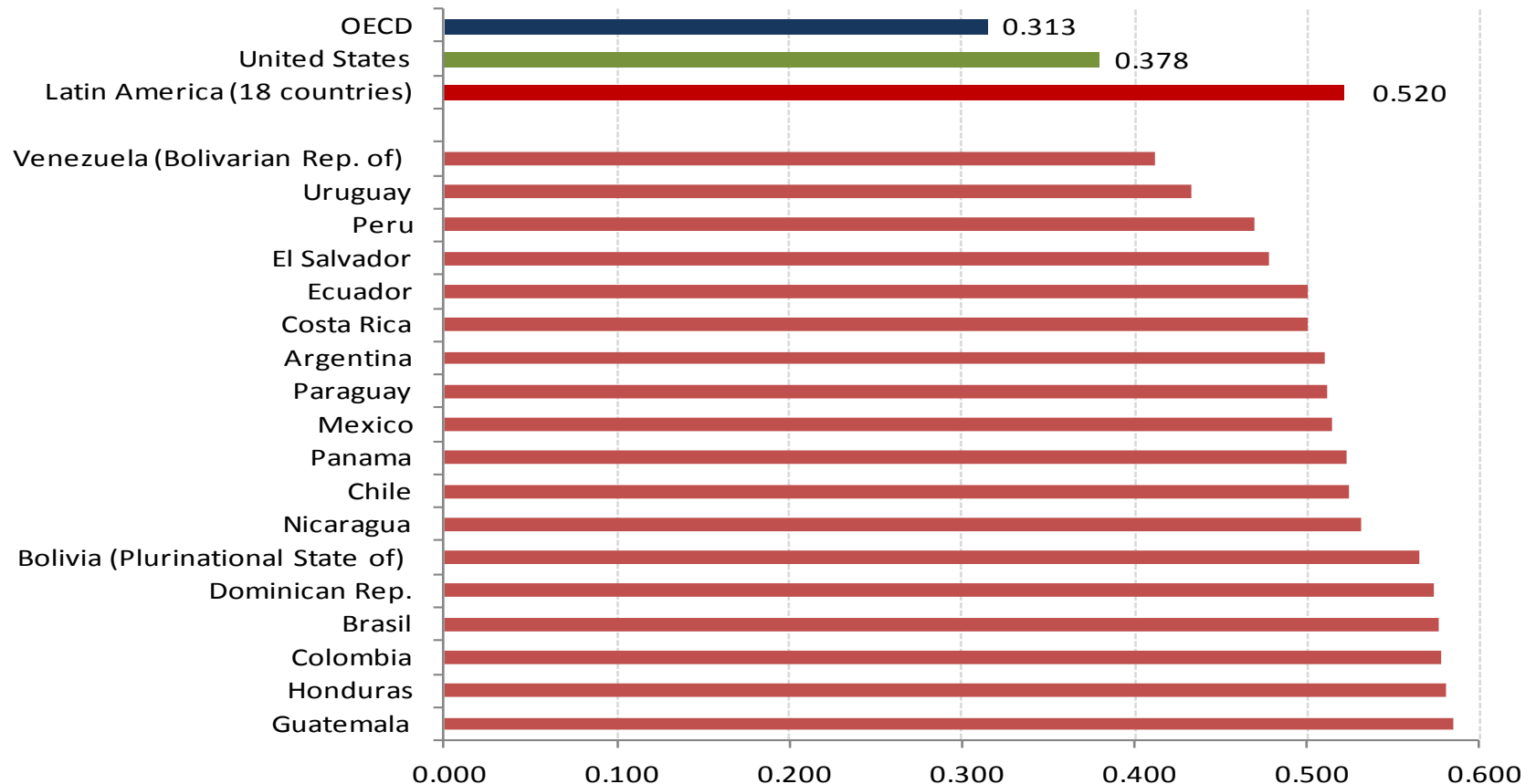
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But within the region, differences are remarkable

GINI INDEX IN LATIN AMERICA, LAST DATA AVAILABLE



Estimations of the PIT potential collection in Latin America

- Using the “tax effort” methodology and with a panel data model
- The author estimates the ability of LA economies to generate a level of taxation
- And obtains an estimate of tax effort to determine whether countries are raising above or below its potential.

■ **Structural variables:**

- Degree of economic development (log of GDP pc)
- Composition of economic activity (share of agriculture in GDP)
- Degree of economic openness (share of exports and imports in GDP)
- Dependence on external funding (external debt as a percentage of GDP)
- Inequality in income distribution (Gini index)
- Education (proxy: public spending on education over GDP)
- Stability of government: the number of periods since the most recent change of regime or the end of the transition period defined by the lack of stable political institutions (IDLA).
- Informal economy (as a proxy for low tax morale)

Estimations of the PIT potential collection in Latin America

COUNTRY	IT	PIT
ARGENTINA	Above potential in 2004-2006	Below potential
BRAZIL	Above potential	Above potential
CHILE	Above potential since 2005	Below potential
EL SALVADOR	Above potential since 2003	Above potential since 1994
GUATEMALA	Above potential since 2006	Below potential
MEXICO	Above potential in 1992-1993 and in 2008	Above potential since 2000
PERU	Above potential since 1996	Above potential since 1997

The Personal Income Tax in Latin America

- **The Income Tax and the Personal Income Tax in Latin America**

And high tax expenditures reduce the tax bases

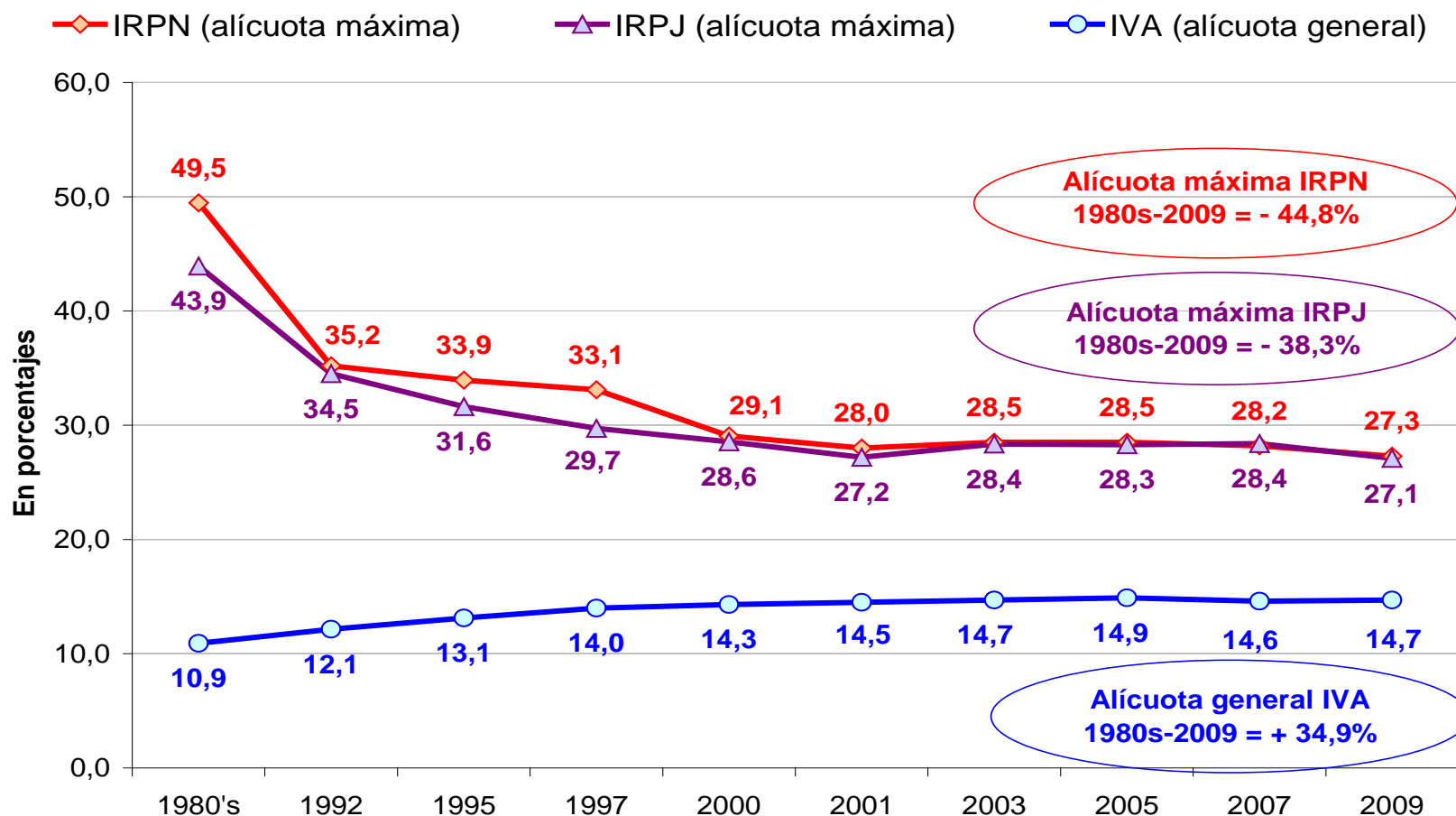
TAX EXPENDITURES IN LATIN AMERICAN COUNTRIES - Year 2007
(in percentage of GDP)

Impuesto	Argentina	Brasil	Chile	Colombia	Ecuador	Guatemala	México	Perú
IVA	1,14	0,36	0,76	1,92	3,40	1,96	2,15	1,44
Renta	0,51	1,11	4,21	1,60	1,20	5,28	3,02	0,29
<i>Pers. Naturales</i>	-	0,66	3,31	0,24	0,80	4,35	1,56	0,19
<i>Pers. Jurídicas</i>	-	0,45	0,90	1,36	0,40	0,93	1,45	0,10
Seguridad Social	0,25	0,74	-	-	-	-	-	-
Selectivos	0,13	0,00	-	-	-	-	-	-
Comercio exterior	0,16	0,08	-	-	-	0,20	-	-
Otros	0,02	0,00	-	-	-	0,46	0,76	0,32
Total (% del PIB)	2,21	2,29	4,97	3,52	4,60	7,91	5,92	2,05
Total (% de la recaudación)	8,90	9,10	24,60	22,00	35,30	63,50	50,70	11,90
GT IRPN /								
GT Total (en %)	-	28,8	66,6	6,8	17,4	55,0	26,4	9,3

Source: L. Villela, A. Lemgruber, M. Jorrat (2009) based in official information.

Legal tax rates for Income taxes were reduced in the last three decades

EVOLUTION OF THE LEGAL TAX RATES – INCOME TAX AND VAT – IN LATIN AMERICA



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