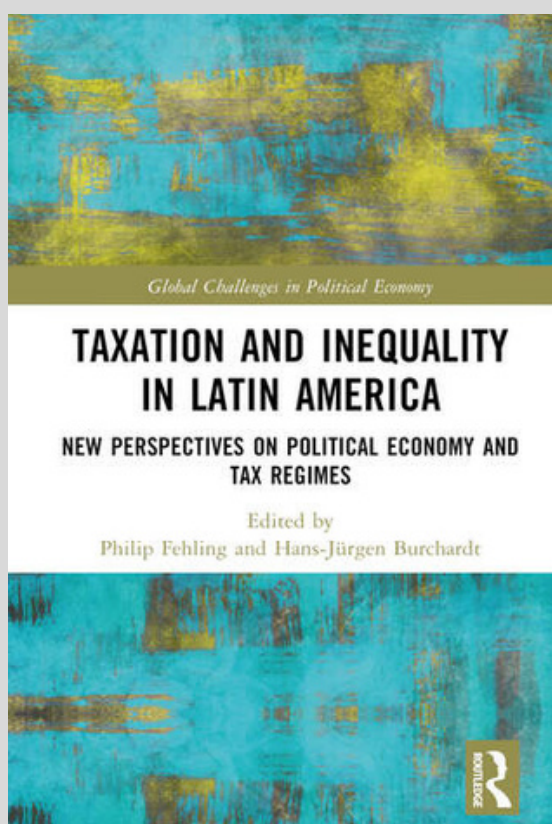


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## **Review: Taxation and Inequality in Latin America: New Perspectives on Political Economy and Tax Regimes (2023)**

**By Abdul Muheet Chowdhary**



The volume *Taxation and Inequality in Latin America: New Perspectives on Political Economy and Tax Regimes* is an insightful collection of articles about the patterns of inequality in Latin America and detailing the nature of tax avoidance and evasion in the region, with lessons from political attempts to bring about progressive reforms and tax considerations for policymakers about the future of the region's development.

*Le livre "Taxation and Inequality in Latin America : New Perspectives on Political Economy and Tax Regimes" est une collection perspicace d'articles sur les modèles d'inégalité en Amérique latine, détaillant la nature de l'évasion et de la fraude fiscales dans la région, avec des leçons tirées des tentatives politiques de mettre en œuvre des réformes progressives et des considérations fiscales pour les décideurs politiques sur l'avenir du développement de la région.*

*El libro "Taxation and Inequality in Latin America: New Perspectives on Political Economy and Tax Regimes" es una perspicaz colección de artículos sobre los patrones de desigualdad en América Latina, que detalla la naturaleza de la elusión y evasión fiscal en la región, con lecciones de intentos políticos para llevar a cabo reformas progresivas y consideraciones fiscales para los responsables de las políticas sobre el futuro del desarrollo de la región.*

## Introduction

A review of the volume [\*Taxation and Inequality in Latin America: New Perspectives on Political Economy and Tax Regimes\*](#), edited by two German academics, Philip Fehling and Hans-Jurgen Burchardt, shows it to be a valuable contribution to the literature on this topic. This is for several reasons.

*First*, the contributions are written by scholars predominantly from Latin America, but in English, thus making it accessible to a wider audience. This is a refreshing change from the usual trend where much of the English language research on the region is by Western academics. It is valuable to hear the Latin American scholars speak in their own voice.

*Second*, the book is explicitly focused on *political economy* (not just abstract economics) and tax regimes, examining the three issues in conjunction, underpinned by an explicit concern with inequality. This approach has resulted in a rich, policy-relevant analysis grounded in the real world that provides a better understanding of “why things happen”.

*Third*, the range of topics covered is quite varied. The volume is structured into three parts, the first on taxation and the dominance of raw material export sectors, the second on taxation and allocation politics and the last on political economy and tax regimes.

*Fourth*, the book is rich in facts and trends, some of them quite shocking.

Some of the best chapters in the book are those written by authors with practical experience in taxation, such as the brilliant chapter on tax evasion in Latin America, written by a tax administrator from Argentina. Future such volumes should ensure more voices by practitioners.

## Worrying Facts About Taxation in Latin America

The opening chapter is written by Fehling and Burchardt and is titled “Reorienting the tax debate: Political economy and tax regimes in Latin America”. It provides a helpful overview of taxation in the region, and more importantly lists some worrying facts, which are addressed throughout the book by other authors. Some of the key facts are as follows:

*Tax regressivity*, i.e. the rich do not pay enough while the poor pay disproportionately more. The top 10% of incomes in Latin America pay an average of 5% on their income. The high reliance on consumption taxes is another indicator of this regressivity.

*High tax evasion*. Revenue losses from tax evasion correspond to 6.3% of gross domestic product (GDP), and offshore wealth in some countries accounts for a shocking 60% of GDP. Tax evasion is expected to account for around 50% of potential revenues from income and profits in the region.

*Regressive tax exemptions*. The ratio of tax exemptions to revenues is extremely high in several countries, in some cases exceeding 50%. This often ends up benefiting the wealthier sections of society – reinforcing inequality - especially through reduced tax rates for capital income and multiple exemptions and deductions.

It is interesting to note that the Platform for Taxation in Latin America and the Caribbean (PTLAC) has recognized these problems and highlighted progressive taxation and tax benefits/exemptions as [two of its four priorities to be addressed](#) (the other two being digital and environmental taxation).

## Dominance of Raw Material Export Sectors

Chapter 2 “Natural resource wealth and fiscal institutions in Latin America since independence” by Luis Bértola, Cecilia Lara, and Camilo Martínez takes a macro look at the evolution of fiscal institutions in Latin America.

The next chapter, “Fiscal revenues from hydrocarbons and minerals in Latin America: Challenges in an era of unprecedented decarbonization and growing digitalization” by Juan Pablo Jiménez and Andrea Podestá poses an important question every resource rich Latin American country (and indeed every such country in the developing world) will have to answer as soon as possible: how to re-orient their economies given the end of the fossil fuel era and potentially reduced demand for natural resources?

The chapter shows Latin America’s excessive reliance on natural resource extraction for revenues and flags the danger when the demand for these resources may/will drop. Unfortunately, when it comes to giving a much-needed solution, no specific recommendation is given.

Chapter 4 titled “The political economy of mobilizing tax resources in Bolivia”, by Verónica Paz Arauco & Wilson Jiménez Pozo, is mainly of relevance to someone interested in the issues concerning this country. The following chapter, “Tax culture: A conceptual proposal and empirical approach to the economic elite in Chile” is on the concept of ‘tax culture’ as applied to the Chilean elite. The author, Jorge Atria, shows through survey data that by and large, there is a general perception in the Chilean society that the poor pay more and the rich pay less in taxes. Interestingly, even the Chilean elite broadly share this view. Having established this, Atria takes the helpful step of examining the elite’s justifications for avoiding taxes. He finds four reasons:

*(i) civic-ontological, i.e., formative or cultural weaknesses of certain individuals or groups; (ii) regulatory, which refers to the opportunities offered by the Chilean system and the need to be competitive in the market; (iii) compensatory, which points to the need to compensate for damages or injustices that the system generates against the taxpayer; and (iv) affirmative, which vindicates creative tax compliance as an option that is consistent with the design of the system and as a productive strategy that will result in greater growth, investment, and wealth creation for the country.*

These reasons could potentially be shared by other elites in other countries, and is a typology which can be built on for further study. Atria also shows the large-scale use of investment companies for tax avoidance and, based on some interviews with the Chilean elites, his data suggests that elites appear determined to avoid taxes no matter what.

Part 1’s final chapter “Tax evasion and capital flight in resource-rich Latin America: What we can learn from Argentina” by Veronica Grondona is one of the best chapters in the entire book. Grondona, a Director of International Taxation in the Argentine national tax agency (AFIP), writes from her practical and real life experience, bringing much value to the volume. She begins with the sobering fact that around 60% of world trade happens *within* multinational enterprises (MNEs), giving them great power to shift profits from developing countries to other jurisdictions through multiple methods, including transfer pricing.

Grondona proceeds to explain how this happens. “Branches are created in jurisdictions with little to no taxation to centralize financial operations or research and development costs, logistics operations, or even the centralization of purchases with subcontractors.” She gives many more examples, followed by the Argentine tax administration’s valiant efforts to counter such tax avoidance. She uses country by country reporting

data to identify the most 'risky' jurisdictions from Argentina's perspective: Luxembourg, Chile, Lebanon, the Netherlands, Turkey, South Korea, and the United Arab Emirates. The chapter contains plenty of original data sourced from AFIP. There is a need for more tax administrators to publish similar studies using the data they have access to.

Grondona also draws attention to an under-studied aspect of international tax avoidance: dividend payments and how when used in conjunction with tax treaties can be a deadly method of base erosion. This forms the bulk of the chapter, illustrated through two case studies of treaty shopping, both involving exports of raw materials: Molinos Rio de la Plata and Yamana Gold.

In the Molinos case, a complicated network of tax treaties spanning Argentina, Chile, Uruguay and Peru was used to avoid taxes. In 2021, the majority of the magistrates of the Argentinian Supreme Court of Justice (CSJN) voted in favor of the Treasury in a lawsuit involving a substantial sum upwards of 65 million pesos (approximately US\$17 million as of December 31, 2019).

The Yamana Gold case again involved a complex web of treaties involving Barbados, Chile, Argentina and the Netherlands to avoid taxes through dividend payments. Grondona warns that the network of tax treaties provides plentiful opportunities for future such tax avoidance. One can only imagine how much revenue is lost by developing countries on a daily basis.

The chapter also points to the undervaluation of exports (sell for cheap) and overvaluation of imports (buy expensive) as methods of profit shifting, and Argentina's pioneering of the 'Sixth Method' in transfer pricing to counter this.

Grondona concludes by stating that while developing countries have some tools at their disposal, effective solutions remain to be developed to tackle key channels of profit shifting such as interest payments, services and royalties, despite the Organisation for Economic Co-operation and Development (OECD) Base Erosion and Profit Shifting (BEPS) Action Plan.

## Taxation and Allocation Politics

Part II of the volume makes an important contribution. It begins with a rather broadly-titled chapter "The political economy of failed progressive fiscal reforms in Latin America" by Rafael Dominguez Martin. It attempts to explain why such reforms failed. Martin uses the dependency theory framework of the great Raul Prebisch to carry out his analysis, arguing the failure was due to a mix of internal and external factors. The external factors mainly involved well-documented Western interference, with the insightful example of the United States of America defending its corporations from progressive reforms in Honduras, Peru, Argentina and Brazil and backing the wave of destabilizing *coup d'etats* under the Kennedy and Johnson administrations. The internal factors were a local "extractivist elite that was incorporated into the ranks of the transnational elite" and remained loyal to Western, particularly US, interests.

He underlines the need for redistribution and references Prebisch's calculations in the 1960s that compressing the consumption of Latin America's upper social stratum so that it was no more than 11 times that of the lowest social stratum would allow the annual per capita income growth rate to rise from 1% to 3%, and if the difference were reduced to 9 times, the rate could reach 4%. Modern research continues to support this essential finding, with the [World Bank in 2019](#) arguing that reducing each country's Gini index by 1 percent per year has a larger impact on reducing global poverty than increasing each country's annual growth by 1 percentage point.

Martin ends his chapter with a clear way forward: "combat tax avoidance and evasion, strengthen direct taxation on personal and corporate income, expand wealth and property taxes, and look into corrective taxes related to the environment and public health." Virtually all of his recommendations are reflected in the PTLAC's four priorities.

The following chapter by Gabriel Ondetti titled “Redistributive threats, development models, and taxation in Latin America” is also one of the best in the volume. It makes a clear hypothesis that episodes of major redistributive reform, especially ones involving serious threats to private property, have indirectly influenced taxation by strengthening forces ideologically opposed to state intervention in the economy. This is the kind of academic analysis that is invaluable to practitioners – the ability to evaluate a large volume of data and detect a pattern.

To back up his claim, Ondetti points to the experiences of Chile, El Salvador, Guatemala, Mexico, Nicaragua, and Peru, in all of which “serious threats to private property” were claimed by businesses, leading to strong business associations opposed to progressive reforms. On the other hand, Argentina, Brazil, the Dominican Republic, Ecuador, Paraguay, and Uruguay did not face such existential threats to private property, and thus lack such well-organized business associations.

This hypothesis is reinforced through the chapter on the Chilean elite mentioned previously, and by the following two chapters “A close relationship with the economic elite: the historical roots of the poor Mexican tax state” by Mónica Unda-Gutiérrez and “Business coordination and regressive taxation in Latin America” by Nestor Castañeda. Castañeda, in particular, makes a clear argument that the ability of business groups in Latin America to organize themselves has been a key factor that has affected the ability of countries to introduce progressive reforms. Where business has been well organized, such reforms have been blocked, and where it has not, such reforms have a better chance of being carried out. His excellent chapter is a must-read for politicians, government officials and civil society activists who advocate progressive reforms.

Ondetti concludes by suggesting that “one potential lesson that emerges from this chapter is that a focus on incremental redistribution achieved mainly through fiscal and regulatory policies may be more effective, because it is more politically sustainable, than one that seeks immediate transformation through sweeping property redistribution. Moderate property reform that does not cast doubt on the survival of private property more generally may also be feasible.”

The last two chapters in this part, “Ground rent, capital accumulation and the limits of taxation in resource-rich countries. The case of Argentina (1993-2020)” by Gastón Caligaris and “Tax regime and exchange rates in Uruguay. Instruments of appropriation of agrarian ground rent” by Gabriel Oyhançabal Benelli, unfortunately do not match the quality of the other chapters, contain little practical insight into taxation, and are written in largely incomprehensible philosophical jargon.

### **New Perspectives on Political Economy and Tax Regimes**

The final part of the volume contains only two chapters. The first, “Raw materials, tax reforms and sustainable development: Lessons from Latin America” by Burchardt -admittedly a bit hard to read given its ponderous writing style- essentially argues that over-reliance on raw materials undermined the growth of other parts of Latin America’s economy and prevented structural and redistributive reforms. It states that there is expected to be a phase of ‘green extractivism’, where minerals relevant to green technologies such as electric cars and the like will rise in demand, which Latin America can meet. However, it recommends that policymakers ensure that such activities lead to the creation of social-security embedded, high-skilled employment in less resource-intensive green jobs and high-value jobs. He warns that if this is not done,

What will remain is a region even further depleted of resources and people. History may well repeat itself – only this time as a farce. After all, the responsible politicians were fully aware of what had to be done in due time.

One can only hope that his advice is listened to.

The final chapter by Fehling, “Contours of rent-based societies: Concluding remarks and new perspectives on political economy and taxation”, philosophizes about the ‘contours of the rent-based society and tax regimes’ arguing that it allows for a more profound understanding of the specificities of Latin American fiscal policy and concludes the book by emphasizing that “more social participation in political and economic decision-making...marks a key point of leverage to overcome structures of privilege, foster a democratic culture and, ultimately, to devise a new social contract that allows for the reproduction of society within the planet’s limits.”

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