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Introduction

Recent decades have seen large increases in taxation in Latin America. The average tax burden in the region has risen by almost a third since 2000 and now stands at more than 20 percent of gross domestic product (GDP). The conventional wisdom that Latin American tax systems generate too little revenue to promote economic and social development seems harder to sustain today than in the past.[1] What continues to be striking about the region's tax burdens, however, is the great disparity between them. While countries like the Dominican Republic, Guatemala, Mexico, and Panama have tax revenues of 13–16 percent of GDP, which is indeed a low level of taxation by international standards, in Argentina, Bolivia, Brazil, and Uruguay the burden is roughly double that amount.

The purpose of this book is to shed light on the origins of these differences. That goal is not grounded in the assumption that more taxation is necessarily better. Public revenues are not always spent in judicious or public-spirited ways, and Latin America faces longstanding problems with clientelism and corruption. In addition, taxation has done relatively little to promote social equity in this highly unequal region, both because it tends to rely heavily on regressive levies and because much of the resulting revenue flows to relatively well-off groups. Nevertheless, a productive tax system provides at least the potential for effective state intervention, something lacking in low-tax countries like Guatemala and Haiti. It also guards against problems of unaccountable governance that scholars have sometimes attributed to reliance on "unearned" income like natural resource rents and foreign aid (Moore 2008). Finally, even fiscal systems that are inefficient from an equity perspective may effect some redistribution if they collect enough revenue. It is

[1] The observation that Latin American tax burdens are unusually low, or lower than would be ideal, can be found in many studies, including Bird and De Wulf (1973), Inter-American Development Bank (1998), Bird (2003), and Gómez Sabaini (2006).

no accident that the Latin American countries with the largest tax burdens are also the ones in which the fiscal system is most equalizing (Hanni et al. 2015; Lustig 2016, 2017).

Admittedly, this is not the first scholarly work to tackle the puzzle of tax burden variance in Latin America. A handful of other studies have done so (Cetrángolo and Gómez Sabaini 2007a; Martín-Mayoral and Uribe 2010; Dioda 2012). In addition, several works have integrated the Latin American countries into broader analyses of this question (Lotz and Morss 1970; Gupta 2007; Pessino and Fenochietto 2010). Nevertheless, almost all these studies rely exclusively on large-N statistical methods. This is the first book-length study dedicated to explaining the determinants of taxation level in Latin America using qualitative comparison.[2] To be sure, there is a growing body of qualitative research on the politics of taxation in Latin America, which has generated valuable insights, but this literature focuses mainly on particular types of taxes, especially more progressive "direct" taxes, rather than the overall tax burden (Lieberman 2003; Fairfield 2010, 2015; Flores-Macías 2014). This difference is significant because countries with larger and more redistributive public sectors tend to rely mainly on indirect and social security taxes, rather than direct ones (Kato 2003; Beramendi and Rueda 2007).

More specifically, the question of tax burden variance is investigated here through an in-depth comparison of four countries: Argentina, Brazil, Chile, and Mexico. Despite sharing several theoretically relevant characteristics, including a substantial level of economic development by regional standards, a political regime widely regarded as democratic, a presidential system of government, and a similar history of external military conflict, these countries have sharply divergent levels of contemporary taxation. Brazil and Argentina have the largest tax revenues in Latin America relative to GDP. Mexico, despite a recent uptick, has a tax burden well below the regional average. Chile is an intermediate case. Why, the book asks, do these otherwise fairly similar countries have starkly different tax burdens?

Most existing theories of taxation shed little light on this puzzle. While some of the independent variables they propose are controlled by the case selection, even those that are not are generally unconvincing. For example, established variables such as trade openness, dependence on agriculture, and federalism are flatly contradicted by the cases. Nevertheless, some others do illuminate aspects of this question. Perhaps the most obvious is nontax revenue from natural resource extraction, often seen as depressing taxation by providing an

[2] Some other book-length studies use qualitative comparison to address related questions. Schneider (2012) examines (among other variables) the increment in the tax burden in recent decades in Central America. Kurtz (2013) explores the roots of longstanding differences in general state capacity among the South American countries. Although Kurtz views the contemporary tax burden as largely reflecting underlying state capacity, this book will challenge that notion.

alternative means for financing public spending. Such revenues clearly help explain the especially light taxation in Mexico.[3] However, for reasons elaborated later, resource revenues constitute only a very partial solution. Some other theories, including path dependence theory, power resources theory, and recent work on business elites and taxation, are also useful, but their contribution can best be appreciated not in isolation but as part of a broader account that traces a causal connection between the occurrence of property reform and the state's subsequent ability to tax.

To be more specific, the argument developed in the book emphasizes the political impact of historical episodes of large-scale redistribution, especially ones that substantially menaced private property. Such episodes shaped taxation indirectly by influencing in an enduring manner the balance of power between actors favorable and opposed to state intervention in the economy. Ironically, where threats to property were most serious, they had the unintended effect of hindering future taxation by promoting the emergence of interest groups, parties, and other actors deeply committed to combatting state intervention in the economy. In contrast, where such threats were more limited, an anti-statist political bloc of comparable strength failed to arise, and taxation eventually reached a higher level.

Although it weaves together a number of existing strands of scholarship, this argument's emphasis on the lasting impacts of conservative backlash against property reform is new to both the literature on taxation and the broader body of scholarship on Latin American political economy and state formation. While it cannot, by any means, explain all the variance in the level of taxation across the region, it does shed considerable light on the roots of tax burden differences elsewhere in Latin America. It also raises crucial questions, which this book tentatively seeks to answer, about the viability of different approaches to achieving greater social equality in this deeply inequitable region.

The rest of this introductory chapter is divided into five sections: the first provides a concise overview of Latin American tax systems, the second reviews the existing literature on the determinants of the tax burden, the third sketches the argument of the book, the fourth explains the research design, and the fifth provides a map of subsequent chapters.

1.1 TAXATION IN LATIN AMERICA

Tax systems vary on a number of major dimensions, including the volume of revenue they collect, the degree to which collection is centralized in the national government, and the types of taxes that produce the bulk of the revenue. This book focuses exclusively on explaining differences on the first

[3] Natural resource extraction plays an even larger role in Chile's economy but, for reasons discussed in Chapter 2, nontax revenues from this sector make a much smaller contribution to Chile's fiscal system than Mexico's.

of these. Nevertheless, it is useful to begin by providing a broader perspective on Latin American tax systems, both because some theories view the tax burden as partially determined by the degree or character of fiscal centralization, and because, as this book argues, the relative weight of different types of taxation reflects political dynamics shaping the size of the tax burden. In addition, it will enhance the reader's general comprehension of the text to have a basic understanding of how taxation works in the region. The discussion highlights both region-wide patterns and cross-national differences. It also attempts to situate the four case study countries within the broader regional context.

1.1.1 The Tax Burden

Latin American countries have on average brought in slightly over 20 percent of GDP in tax revenue in recent years (see Table 1.1).[4] This is more than a third less than the corresponding figure (34 percent) for the generally far richer countries that comprise the Organisation for Economic Cooperation and Development (OECD).[5] However, it is substantially higher than in the past. The average tax burden in the region increased from 13.6 percent of GDP in 1990 to 15.8 percent in 2000 to 20.8 percent in 2017 (OECD 2019, p. 135) even as the OECD average remained relatively stagnant.[6] The average Latin American tax burden is also higher than the average of developing countries outside the region.[7] As noted earlier, there is much diversity within Latin America, with tax burdens ranging from about 13 percent of GDP to more than 32 percent. The set of countries examined in this book expresses this diversity. Brazil and Argentina are the two most heavily taxed countries in the region. Despite a significant increase beginning in 2015, Mexico is among the more lightly taxed. Chile is an intermediate case with revenues almost identical to the regional average.

Variance in the tax burden reflects key differences in tax policy. Brazil and Argentina have a larger number of significant taxes. For example, Brazil has essentially two different corporate income taxes and two value-added taxes (one each at the national and state levels), while Argentina has an important tax on bank transactions and high taxes on commodity exports. No comparable measures exist in Chile or Mexico. Argentina and Brazil also apply higher rates

[4] Cuba is excluded from regional calculations because its still largely socialist economy makes comparison with other countries complicated.

[5] Chile and Mexico are both part of the OECD, an organization devoted to studying development issues, but they are, along with Turkey, the poorest of its 34 members.

[6] The average OECD tax burden was 31.9 percent of GDP in 1990, 33.8 percent in 2000, and 34.2 percent in 2017 (OECD Global Revenue Statistics Database, www.oecd.org/tax/tax-policy/global-revenue-statistics-database.htm).

[7] The average tax burden in 2017 for non-high-income countries outside Latin America was 19.6 percent (OECD Global Revenue Statistics Database).

TABLE 1.1 *Average tax burden and tax structure, 2013–2017*

Country	Tax revenue/ GDP (%)	Type of tax (% of total tax revenue)				Level of government (% of total tax revenue)	
		Direct	Indirect	Social security	Other	Central	Subnational
Argentina	31.0	28.4	47.3	22.3	2.0	83.2	16.8
Brazil	32.1	30.2	41.3	26.1	2.4	68.3	31.7
Chile	20.1	38.6	53.8	7.1	0.5	92.4	7.6
Mexico	15.1	47.7	36.7	14.3	1.3	94.1	5.9
Regional average[a]	20.1	31.5	47.5	19.2	1.8	90.8	9.2

Sources: CEPALSTAT (estadisticas.cepal.org/cepalstat/portada.html?idioma=english); OECD (2015, 2016, 2017, 2018)
[a] Data for the Dominican Republic, Haiti, and Venezuela exclude subnational governments.

TABLE 1.2 *Selected tax rates, c. 2015*

Country	Personal income tax (minimum/ maximum)	Corporate income tax (standard)	VAT (general)	Social security (% average wage)	Import tariff (average)
Argentina	9/35	35	21	44.5	13.0
Brazil	7.5/27.5	34	28[a]	43.2	13.5
Chile	4/40	22.5	19	23.7	6.0
Mexico	1.9/35	30	16	25.5	8.6
Regional average	9.8/26.6	26.1	15.8	27.5	8.5

Sources: Inter-American Center of Tax Administrations (CIAT) Database (https://www.ciat.org/ciatdata/?lang=en); KPMG (2016); Alaimo et al. (2017); Ernst and Young (2017); OECD (2018).
[a] Combines the state and federal VAT-type taxes. Although most states use a 17 percent rate, the largest ones use 18 or 19 percent. The figure here is based on 18 percent. The federal tax has no general rate, so the value used is a rough average (10 percent) calculated by the accounting firm KPMG (KPMG 2016, p. 4).

for some key taxes (see Table 1.2). Finally, the mandatory pension systems in Argentina and Brazil are wholly public, so all contributions flow into state coffers. In contrast, all but a small percentage of Chile's pension contributions go to private investment funds. Mexico's system is a hybrid, with about 70 percent of revenues entering the public sector.

1.1.2 Centralization

As a rule, tax collection in Latin America, as Table 1.1 shows, is overwhelmingly concentrated in the national government. Even in some countries that are nominally federal in constitutional structure, such as Mexico and Venezuela, tax collection is highly centralized (Díaz-Cayeros 2006, pp. 2–9). In several Latin American countries, subnational governments have come in recent decades to wield substantial control over key policy areas, such as education and health care, and to account for a large share of public spending (Eaton 2002; Falleti 2010). However, even in these countries, states and municipalities obtain their revenues mainly from fiscal transfers from the central government, rather than their own tax collection efforts (Corbacho et al. 2013, pp. 81–83).

The major exception to the rule of tax system centralization is one of the case study countries, Brazil. Both states and municipalities have substantial tax authority and together they bring in about 30 percent of total tax revenue. After Brazil, the countries with the most decentralized tax systems are Argentina and Colombia, where subnational governments account for upward of 15 percent of total tax revenues (OECD 2018). In the Argentine case, it is mainly the provincial governments that matter, since municipalities generally have little tax authority. Mexico and Chile, in contrast, join other Latin American countries in concentrating tax collection overwhelmingly at the national level.

1.1.3 Type of Taxes/Progressivity

Latin American tax systems have been criticized for collecting too little revenue from income and property taxes, which are generally more progressive than other types (Tanzi 2000; Flores-Macías 2019). Known as “direct” taxes because their onus is borne by the payer rather than being passed on to consumers, these taxes contribute less than a third of total tax revenues (see Table 1.1). This figure is lower than the corresponding one for the OECD, as well as Africa and Asia (OECD Global Revenue Statistics Database).[8] In addition, income tax revenues in Latin America come primarily from the corporate income tax, which is often viewed as less progressive than the personal income tax (Mahon 2019). Instead of relying on income taxation, Latin American countries derive the bulk of their revenues from taxes that tend to be neutral or regressive. Most important are “indirect” taxes, a category that includes both taxes on consumption, such as value-added taxes (VATs) and “excise” taxes on specific products, and taxes on foreign trade. In addition,

[8] In 2016, for example, direct taxes contributed 30.8 percent of tax revenues in Latin America, 39.3 percent in the OECD, 36.0 percent in Africa, and 46.6 percent in East Asia (OECD Global Revenue Database).

a substantial amount of revenue comes from the payroll taxes that fund social security systems.

Although the share of revenue derived from direct levies is generally low, it varies substantially across the region, with values ranging from 15 to almost 50 percent. As Table 1.1 shows, the countries examined in depth in this book reflect at least some of this diversity. Mexico and Chile are among the countries in which direct taxes contribute the largest share. Argentina and Brazil do not rank at the bottom, but they are well below the other two.[9] These differences mainly reflect the relative weight of income taxes, since property taxes play a minor role in Latin America.[10] The personal and corporate income taxes contribute roughly similar amounts of revenue in Argentina, Mexico, and Brazil, but corporate taxation is more dominant in Chile, due to its unusual "integrated" income tax regime (discussed in Chapter 3).[11]

It should be noted that, although direct taxes tend to be more progressive, the fact that a country relies heavily on them does not necessarily mean that its fiscal system has a strong redistributive impact, since other variables also affect progressivity.[12] First, both direct and indirect taxes can vary in their distributional consequences, depending on specific design attributes.[13] Second, the impact of revenue also depends on how it is spent. Both the distribution of spending among policy areas and how specific programs are structured are important.[14] Finally, the volume of revenue matters. A fiscal system that taxes and spends progressively may still have little redistributive impact if it brings in only a small amount of revenue. Conversely, one whose design is only mildly redistributive may have a significant impact if it handles a large quantity of resources.

That the magnitude of the tax burden is relevant for equity is reflected by the fact that the Latin American fiscal systems with the largest tax revenues

9 Nevertheless, given their heavier tax burdens, Brazil and Argentina have somewhat larger direct tax revenues relative to GDP. Between 2013 and 2017, Brazil's averaged 9.7 percent of GDP, Argentina's 8.8 percent, Chile's 7.8 percent, and Mexico's 7.2 percent (CEPALSTAT).

10 Property taxation is more significant in Argentina, but this is mainly due to a tax on bank transactions, rather than more conventional taxes, like those on real estate or inheritance.

11 Between 2013 and 2017, personal income tax revenues averaged 50.8 percent of total income tax revenues in Mexico, 46.4 percent in Brazil, 46.3 percent in Argentina, and 23.7 percent in Chile (CEPALSTAT).

12 "Redistributive" and "progressive" are used interchangeably here to describe policies that tend to promote greater socioeconomic equality.

13 For example, as mentioned, the personal income tax is generally viewed as more progressive than the corporate version. With regard to indirect taxes, the regressivity of consumption taxes like the VAT may be attenuated by exempting staple goods like food and medicines.

14 Spending on primary education and preventive health care is especially redistributive because poorer people use those services more than the richer ones. Policy design also matters. For example, policies that transfer cash to individuals can have very different distributive effects, depending on whether they require prior payment of payroll taxes and whether they employ a means test.

(Argentina, Brazil, and Uruguay) also achieve the greatest reduction in income inequality (Lustig et al. 2014; ECLAC 2015, pp. 94–95; Hanni et al. 2015; Lustig 2016, 2017). None of them has a significantly redistributive tax system, but all collect substantial revenue and a good part of it is spent on policies with a redistributive impact.[15] On the other extreme, the countries whose fiscal systems effect the least redistribution tend to be the same ones (e.g., the Dominican Republic, Guatemala, and Paraguay) that collect the least revenue. Mexico and Chile are in the middle of the regional pack, although Chile consistently ranks higher. Despite this variation, even the most progressive Latin American fiscal systems achieve less redistribution than the OECD average, owing both to a lower level of taxation and less progressive tax and spending structures (Hanni et al. 2015, pp. 12–14).

1.2 EXISTING THEORIES

Existing scholarship offers a variety of theoretical tools for solving the puzzle addressed by this book. Although research specifically on the roots of Latin American tax burdens is limited, the broader literature is large and diverse, reflecting the centrality of this question to social science research.[16] Chapter 2 evaluates this literature in light of the cases, but for the purpose of introducing the arguments and research design of the book (in subsequent sections) it is useful to provide a brief overview here. While the focus is on general theories, the discussion also refers to some of the more prominent arguments proposed for specific countries under study here. Others are dealt with in later chapters.

Extant theories can be thought of as falling into three broad categories – economic, institutional, and actor-centric – depending on the causal variable they primarily emphasize. Each of these categories is discussed in turn.

First, though, it is important to touch on an issue that cuts across them. Variance in the tax burden most obviously reflects differences in the legal tax code. However, it can also reflect the degree of compliance with that code (Levi 1988). Noncompliance, or, in other words, tax evasion, is a common phenomenon in developing countries. Numerous studies have underscored its importance in Latin America (Alm and Martinez-Vazquez 2007; Bergman 2009; Gómez Sabaini and Morán 2016). Nevertheless, an emphasis on evasion begs the question of why this problem is more serious in some societies than others. Thus, to the extent that they touch on the subject at all, theories of taxation and overall public sector size portray evasion as a result of

[15] Argentina and Brazil, for instance, boast the region's heaviest spending on targeted anti-poverty programs, especially noncontributory pensions (Arza 2017, p. 15) and conditional cash transfers (Cecchini and Atuesta 2017, p. 31).

[16] The tax burden scholarship is integrated into a broader debate on the "size of government." Spanning the fields of economics and political science, this literature treats taxation and spending as aspects of one variable: the fiscal magnitude of the state. Thus, a few studies cited here operationalize the dependent variable as total public spending, rather than taxation.

deeper causes, including the structure of the economy, the perceived legitimacy of political institutions, and the general efficacy of the state in penetrating society and enforcing the law. Following this logic, the discussion here treats evasion not as a separate explanation of tax burden variance, but rather as a variable that plays a mediating role in some theories.

1.2.1 Economic Theories

A variety of economic conditions have been seen as influencing the level of taxation. Probably the most widely acknowledged is economic development. While there are differing accounts of the causal links involved, development is broadly viewed as promoting greater taxation by boosting societal demand for public goods, such as economic regulation, education, and social protection, which require revenues for their provision (Wagner 1883; Lotz and Morss 1970; Pessino and Fenochietto 2010). Consequently, richer societies should be expected, other things being equal, to have heavier tax burdens. Scholars have also argued that openness to international trade tends to increase public sector size, mainly by generating demands for social insurance against external shocks (Rodrik 1998). Although some studies cast doubt on this relationship (Benarroch and Pandey 2012), most find support for it, at least under certain conditions (Ram 2009; Farhad and Jetter 2019; Ferreira de Mendonça and Oliveira 2019). Moreover, those conditions, including democracy, volatile export prices, and developing country status, generally hold for the countries under study here.

While development and trade integration are usually viewed as promoting heavier taxation, some other conditions are believed to inhibit it. Strong dependence on agricultural production reduces the tax burden because it is harder for the state to enforce compliance in agriculture than in other sectors (Piancastelli 2001; Gupta 2007). Price inflation is sometimes associated with lighter taxation because of the so-called Olivera–Tanzi effect, in which the time lag between a taxable event and the state's receipt of the corresponding revenues undermines the latter's real value (Tanzi 1977; Cetrángolo and Gómez Sabaini 2007a).[17] Scholars view state-controlled natural resource wealth as inhibiting taxation by providing an alternative revenue source that is politically less costly and requires less bureaucratic capacity (Patrucchi and Grottola 2011; Crivelli and Gupta 2014). Finally, at least one study of Mexico argues that the country's proximity to the United States prevents heavier taxation in two ways (Elizondo Mayer-Serra 2014). First, the threat of contraband from the United States puts pressure on Mexican authorities to keep consumption taxes low in border

[17] There are also ways in which inflation can contribute to higher taxation, such as by triggering tax reform (Mahon 2004) or causing income tax "bracket creep" (as discussed in Chapter 6). However, at least in the developing country context, the predominant hypothesis in the literature is that it hinders tax collection.

regions. Second, income taxation is inhibited by the risk of capital flight into the United States.

1.2.2 Institutional Theories

Scholars have also advanced explanations of the tax burden based on the characteristics of a country's political institutions. Most of these emphasize relatively formal differences in decision-making processes, but others focus on the capacity to exert effective governance, which is seen as flowing mainly from deeply rooted informal traditions.

A perspective that falls more clearly into the first category involves the macro-institution of regime type. A common argument is that democracy favors the expansion of spending and taxation, both by granting poorer citizens opportunities to press demands for redistribution and by legitimizing the state's own demands for revenue, thus enhancing compliance (Boix 2001; Besley and Persson 2013; Bird et al. 2014). A more nuanced version argues that under democracy public sector size is a function of income inequality (Meltzer and Richard 1981). When the median voter's income is below average, he or she tends to vote for measures that redistribute income downward through taxation and spending.

These theories focus on democracy writ large. Nevertheless, even among democratic regimes, there are major differences in institutional design. Students of fiscal policy have offered several arguments about how these differences affect public sector magnitude, most of them taken from the experiences of developed countries. One is the proposition that parliamentary democracies tend toward larger public sectors than presidential ones because the separation of powers inherent to the latter makes it harder for politicians to extract rents from the state (Steinmo 1993; Persson and Tabellini 2003). Another is that proportional representation (PR) systems for electing legislators favor higher taxation and spending (Steinmo and Tolbert 1998; Persson and Tabellini 2003). The logic is essentially that PR favors a party system based on multiple competitive parties, while first past the post (FPTP) tends toward a two-party system. Multiparty systems, in turn, facilitate the creation of center-left governing coalitions that strive to redistribute income (Iversen and Soskice 2006).

Other theories emphasize the effects of federalism versus more centralized systems. The classical argument is that, by allowing individuals and businesses to shop around for the lowest tax rate, federalism puts pressure on subnational governments to keep their taxes low and thus leads to a lighter tax burden overall (Brennan and Buchannan 1980). However, other scholars have argued that federalism may lead to greater taxation if spending is decentralized more than taxation (Stein 1999; Rodden 2003). Where such a "vertical fiscal imbalance" exists, subnational governments may be tempted to spend irresponsibly, knowing that the economic and political costs of paying for their outlays will be incurred by national authorities.