

## Sector and Thematic Evaluation

# Comparative Evaluation: Review of Bank Support to Tax Policy and Administration, 2007-2016

# **Comparative Evaluation: Review of Bank Support to Tax Policy and Administration, 2007-2016**

Office of Evaluation and Oversight (OVE)

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Office of Evaluation and Oversight  
1350 New York Avenue, N.W.  
Washington, D.C. 20577  
[www.iadb.org/evaluation](http://www.iadb.org/evaluation)

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## ACRONYMS AND ABBREVIATIONS

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CIAT	Inter-American Center for Tax Administration ( <i>Centro Interamericano de Administradores Tributarios</i> )
CIT	Corporate income tax
DGI	General Taxes Direction (Uruguay)
DEI	Executive Tax Direction (Honduras)
DNA	Customs Administration (Uruguay)
ECLAC	Economic Commission for Latin America and the Caribbean
EFF	Extended Fund Facility
FMM	Fiscal and Municipal Management Division
GDP	Gross domestic product
IMF	International Monetary Fund
IT	Information technology
HR	Human resources
IDB	Inter-American Development Bank
IDB-8 (-9)	Eighth (Ninth) Capital Replenishment
INT	Integration and Trade Sector
LAC	Latin American and the Caribbean
OECD	Organization for Economic Co-operation and Development
OVE	Office of Evaluation and Oversight
PBL	Policy-based loan
PBP	Policy-based programmatic loan
PFM	Public financial management
PIT	Personal income tax
RES	Department of Research and Chief Economist
SAT	Tax agency (Guatemala)
SFD	Sector Framework Document
SIGS	Strategy for Institutions for Growth and Social Welfare
SET	<i>Subsecretaría de Estado de Tributación</i> (Paraguay)
SSC	Social security contributions
TC	Technical cooperation
TC-INTRA	Inter-regional TC
TPA	Tax policy and revenue administration
VAT	Value-added tax

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Given the multisectoral nature of fiscal issues, a first contribution of the evaluation is to identify the universe of projects with tax components and to draw Bankwide conclusions about it.  
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# Executive Summary

**This evaluation assesses the relevance, implementation, and effectiveness of the tax policy and administration (TPA) interventions supported by the Inter-American Development Bank (IDB, or the Bank) over the last decade (2007-2016). To assess relevance, the Office of Evaluation and Oversight (OVE) identified and reviewed all lending and nonlending operations approved during the period that had a tax policy and/or revenue administration component. Given the multisectoral nature of fiscal issues, a first contribution of the evaluation is to identify the universe of projects with tax components and to draw Bankwide conclusions about it. OVE also considered the significant volume of knowledge products and sponsored dissemination activities the Bank has produced on taxation. In addition to conducting a desk review and general relevance analysis of the portfolio, OVE compared the Bank's role in seven countries (Colombia, Jamaica, Guatemala, Honduras, Mexico, Paraguay, and Uruguay) to assess the relevance of design, implementation, and effectiveness. These countries represent a balance among different levels of development, tax burdens, and geographic regions, and account for a sizable share of the Bank's lending engagement.**

IDB support to TPA is embedded in a broader fiscal portfolio, in which the Bank has combined tax work with public expenditure management and macro-fiscal issues. Since 2007, the Bank has approved 150 “fiscal” loans for US\$15.1 billion—equivalent to 15% of total sovereign-guaranteed lending. A large majority of these



loans originated in the Fiscal and Municipal Management Division and included TPA, public financial management, and/or macro-fiscal work (the quality and composition of expenditures was only a minor topic in the identified portfolio). Two-thirds of those loans included TPA components (hereinafter the “TPA portfolio”). The bulk of the financial support to tax issues (80%) has been provided through policy-based lending (PBLs), although most loans were investment projects (58%). Most of the 50 technical cooperations (TCs) with TPA components supported operations, but the portfolio also includes stand-alone TCs. In addition to the operational contribution, the Bank has increasingly produced knowledge products and sponsored dissemination activities.

This extensive lending and nonlending portfolio reflects that the Bank has developed substantial expertise in tax policy (less so in revenue administration) and has positioned itself as a trusted advisor. Since the IDB’s Realignment, the Bank has increased its strategic and operational emphasis on taxation. As OVE learned from interviews, there is consensus that the Bank has enhanced the soundness of its technical work and has strengthened its reputation in fiscal matters—a reputation that has resulted in an implicit partnership with the International Monetary Fund (IMF), especially in Central America and the Caribbean. In addition, the Bank has successfully developed informal and long-term relationships with most countries. In this regard, one of OVE’s main findings is that part of the Bank’s value added and effectiveness comes from its informal assistance and ad hoc technical advice, which is usually financed in an ad hoc manner and at high transaction costs. These efforts can easily pass unnoticed but are crucial, since they have helped position the Bank as a trusted advisor. Yet two caveats are worth mentioning. First, IDB’s in-house expertise is more geared toward tax policy, so that the Bank is particularly dependent on external consultants in the area of revenue administration. Second, IDB’s reputation on fiscal matters is relatively recent and highly dependent on key personnel, so turnover of key staff could change IDB’s role and capacity suddenly.

The tax components in IDB loans are generally aimed at raising tax revenues—a highly relevant objective. The Bank has focused on countries with lower revenue capacity (especially in Central America), as tax revenues below 13-15% of GDP are considered inconsistent with sustained real GDP growth. Moreover, many of the Bank’s interventions in TPA have taken place after a crisis, aiming to increase revenue to put the public sector’s budget on a more sustainable path and thereby avoid the economic and social costs of macroeconomic distress. The Bank has also devoted significant efforts to enhance revenue capacity at the subnational level, especially in South America, as part of a strategy to boost property tax receipts and decrease reliance on central government transfers.

Explicit consideration of trade-offs between revenue and other policy goals has been less frequent, though the equity and efficiency implications of reforms appear to have been implicitly recognized. Few loans have included equity or economic efficiency

as objectives, though reforms to income and property taxes and reductions in tax expenditures can often be expected to enhance equity or efficiency. Some Bank knowledge products have analyzed trade-offs between these goals more explicitly. More broadly, many experts argue that it is more effective to address equity concerns through the spending side of the budget.

The emphasis on raising revenue, mainly by strengthening the capacity of collection agencies (revenue administration) and broadening tax bases (tax policy), has been consistent with country priorities and best practices. Latin American countries forgo an estimated 6.3% of the region's GDP because of tax expenditures and noncompliance. Therefore, broadening the tax base and enhancing the capacity of collection agencies are highly relevant approaches. In some countries, though, the relevance of project design was more modest because of long-lasting governance problems. The technical reforms supported in some low-capacity countries were by design unlikely to have a significant impact because they overlooked the main binding constraints to improving tax collection capacity. In addition, project diagnoses could in some cases have been strengthened by a deeper discussion of expenditure issues.

Generally speaking, there was a consistent use of instruments, with PBLs mostly supporting tax policy reform and investment loans financing expenditures for capacity building. Yet there is room for more complementarity between tax policy and revenue administration projects. In the area of revenue administration, there was a marked preference for investment loans, although tax administration measures were also supported by PBLs. When PBLs were used, it was important to have parallel TCs or investment loans to support reform implementation—an aspect that did not always receive enough attention. In fact, the relevance of including revenue administration conditions in PBLs with no associated TCs or investment loans is questionable—especially in countries with lower income and capacity. Only in Honduras, Jamaica, and Uruguay did the Bank support a “tax program.” Moreover, since OVE's case studies indicate that clients highly value IDB's know-how on reform implementation drawn from experience in other countries in the region, there seems to be room for the Bank to foster more horizontal cooperation and better exploit the use of “intra-regional” technical cooperation.

While active in both large and small LAC countries, the Bank's role seems to vary according to the characteristics of the countries. In more advanced countries, the IDB is viewed as a partner that can provide specific (niche) knowledge and, in some cases, as a vehicle to facilitate consensus and provide a seal of approval. In Brazil, Colombia, and Mexico, for example, the Bank has supported the design and implementation of electronic invoicing systems for tax collection (at the national or subnational level depending on the country). In less advanced countries, the Bank has had a more hands-on role, actively participating in the restructuring of tax collection agencies and helping draft legislation.

The implementation of investment loans was affected by significant delays, which in some cases led to design obsolescence. Even relative to Bank investment loans in general, the execution of loans with tax components is typically slower—especially for components that support reforms of tax collection agencies. As a result, the extensions of loans with tax components are longer than the Bank average. In some cases, weak coordination between Bank divisions and design flaws partly explain implementation difficulties, although in general most difficulties stem from long procurement processes and resistance to change within the tax agencies. Since such reforms are time-sensitive and political, slow execution increases the chance of losing government ownership and thus the windows of opportunity for change. In instances when priorities changed, the Bank was flexible to accommodate loans to countries' changing needs.

In terms of outcomes, IDB support helped Jamaica and Uruguay pursue substantial—and, implementation issues notwithstanding, generally successful—TPA reforms, but in the other five countries results have been limited. In Jamaica, the 2013 reform—put forward with IMF and IDB support—reduced exemptions and waivers, leading to an increase in tax collection and improvements in the economic efficiency of the tax system. There are also signs that the IDB has contributed to progress in tax administration: a reduction in tax noncompliance and an increase in audits and taxpayers e-services. In Uruguay, also in the context of a program with the IMF, the Bank supported the 2006-07 tax reform, which implemented the first dual tax system in Latin American and the Caribbean (LAC) and rationalized the tax structure, substantially improving the equity of the system. In tandem, the Bank was instrumental in the modernization of the internal revenue office, which translated into higher control and audit capabilities and ultimately into higher compliance. In the other countries, results have been generally modest.

Four aspects of the Jamaica and Uruguay programs seem to have contributed to IDB's effectiveness. First, swiftly seizing the windows of opportunity and working with organizations that assumed the role of "reform champions" served to advance the reforms. In contrast, in Honduras and Guatemala lack of government ownership or actual opposition limited positive results. Second, reforms have generally been more effective when tax policy and revenue administration were addressed together under a comprehensive and internally consistent reform program. Third, in Jamaica and Uruguay the Bank and the IMF established implicit partnerships. Coordination has been even greater in the context of an IMF-supported program—which likely reflects that multilaterals have higher leverage in moments of high fiscal needs. Finally, long-term sustained engagement—including policy dialogue and TCs—proved a key element.

The ability to secure consensus, particularly with the private sector, contributed to the effectiveness and sustainability of reforms. Since tax reforms are as political as they are technical, the inability to secure consensus over time and the prevalence

of vested interests can undermine reforms. This reinforces the fact that tax reforms are time-sensitive and that IDB engagement often needs to extend beyond the life of a project.

Sustainability tended to be less likely in the context of weak institutions of accountability. TPA reforms are necessary but not sufficient to improve government revenue. Other elements, such as strong complementary institutions (e.g., the judiciary), and checks and balances to prevent wrongdoing (e.g., corruption), need to be in place. Countries in which government institutions were weaker tended to experience reversals in tax policy and deterioration of their tax agencies.

Support for TPA, like support for reforms in general, calls for a relations-based engagement—which is not entirely consistent with the project-based model under which the Bank operates. IDB's policies and procedures have been tailored for a specific project model, with clearly defined implementation schedules, outputs, and outcomes. IDB support for financial and procurement processes adds value, and staff incentives and budget allocations are based on project approvals and disbursements. However, policy reforms and capacity-building processes—including those in TPA—generally require a different type of support. Because policy reforms face complex political economy challenges, evolve in a nonlinear fashion, and are particularly time-sensitive, Bank support needs to build on a relations-based model founded on technical reputation, knowledge, and trust. But even using the project-based model, the Bank has been able to improve its reputation, knowledge, and trustworthiness in taxation over the review period.

Based on the evaluation findings, OVE has four specific recommendations and a more general one:

- Continue to work towards understanding and addressing trade-offs in fiscal reforms. Since LAC continues to be the most unequal region in the world, the Bank's knowledge products and policy dialogue in the fiscal area should systematically strive to address equity as well as efficiency and revenue needs, whether through tax or expenditure policies. Moreover, whenever possible, Bank projects should recognize the implications on equity and efficiency of the supported tax reforms.
- Support the trusted advisor role by ensuring sufficient and sustainable in-house expertise in both tax policy and revenue administration. This may entail strengthening in-house know-how on revenue administration, while continuing to use specialized consultants to provide specific expertise as needed. Since the trusted advisor role is sensitive to staffing in the organization, the Bank will need to have training and transition arrangements in place to ensure that the role is sustainable even with staff turnover.



Since 2007, the Bank has revamped its organizational structure and developed a significant fiscal portfolio. In 2006 the Bank realigned its structure and created a dedicated unit for fiscal issues, the Fiscal and Municipal Management Division (FMM).  
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- Foster greater cooperation among tax authorities in LAC. The Bank should play a key role in engaging the more advanced countries in the region (as well as the higher-capacity states and municipalities) to share knowledge with revenue administrations in less developed locations. In this effort, further use of TC-INTRA is recommended. The partnership with the Inter-American Center for Tax Administration should also be strengthened to facilitate the sharing of best practices.
- Continue to seek synergies between the Bank's support for tax policy and revenue administration. Strengthening a tax system typically requires policy reforms as well as changes in implementing institutions. Though simultaneous Bank support to both may not be feasible or requested by the authorities in every country context, the Bank should continue to look for opportunities to provide synchronized support through an appropriate mix of PBLs, investment loans, and reimbursable and/or non-reimbursable TCs as needed.
- Adapt Bank processes and procedures to facilitate longer-term and continuous support to clients. The trusted advisor role and the *acompañamiento*—two of the identified sources of IDB value-added in TPA—require that Bank staff devote time to knowledge generation activities, keep engaged in policy

dialogue, and continue supporting the reform process even after the end of an IDB operation. To this end, the Bank should explore new or expanded uses of instruments to facilitate longer-term and continuous engagement, such as reimbursable programs of technical assistance with less specific up-front identification of expected results. The Bank should also revisit staff incentives to better recognize and reward the trusted advisor role.





The evaluation combines the identification and desk review of the Bankwide TPA portfolio with an in-depth analysis of the IDB's role in seven countries.  
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# 1 Introduction

**Sufficient tax revenue is necessary to finance the public expenditures that are crucial for economic growth. Although the primary purpose of taxation is to raise revenue to finance government expenditures, taxation can also be used to improve equity, address externalities, and promote such goals as directing investment into certain sectors.**

Despite the relevance of taxation for the development of Latin America and the Caribbean (LAC), it was not until recently that the Inter-American Development Bank (IDB, or the Bank) strengthened its strategic and operational approaches to tax policy and revenue administration (TPA). During its first 30 years, the IDB provided support on tax issues through non-reimbursable technical cooperation (TC), mostly through regional institutions.<sup>1</sup> The typical TC focused on tax systems diagnoses, training in TPA, and updating of tax procedural codes (Office of Evaluation and Oversight 2008). In the early 1990s, in the aftermath of the Latin American debt crisis and in the context of a liberalization and reform process, the Bank first identified TPA as a strategic priority. It focused on lending for reforms through policy-based loans (PBLs) and emphasized increasing revenue as a means of overcoming the structural fiscal challenges facing countries in the region.<sup>2</sup>

Translating strategic priorities into practical guidelines for prioritizing and implementing operations proved challenging. Following IDB-8, several frames of reference and sector strategies were approved, but the Bank still lacked a clear strategy in the fiscal area (IDB 1996, 2003).<sup>3</sup> The commitment on TPA was reinforced by IDB-9 (2010), which called for the introduction of effective and socially balanced tax systems and included increasing the ratio of actual to potential tax revenues as one of the regional development goals (AB-2764). In that context, the Bank approved the “Strategy for Institutions for Growth and Social Welfare” (SIGS), which, although more specific than previous documents, only set a number of aspirational goals and did not discuss trade-offs or specific criteria to prioritize interventions. The first explicit

frames of reference for the Bank's engagement in fiscal matters, with specific guidelines for TPA, were developed in 2015 (Decentralization and Subnational Governments SFD, GN-2813-4) and 2016 (Fiscal Policy and Management SFD, GN-2831-3).

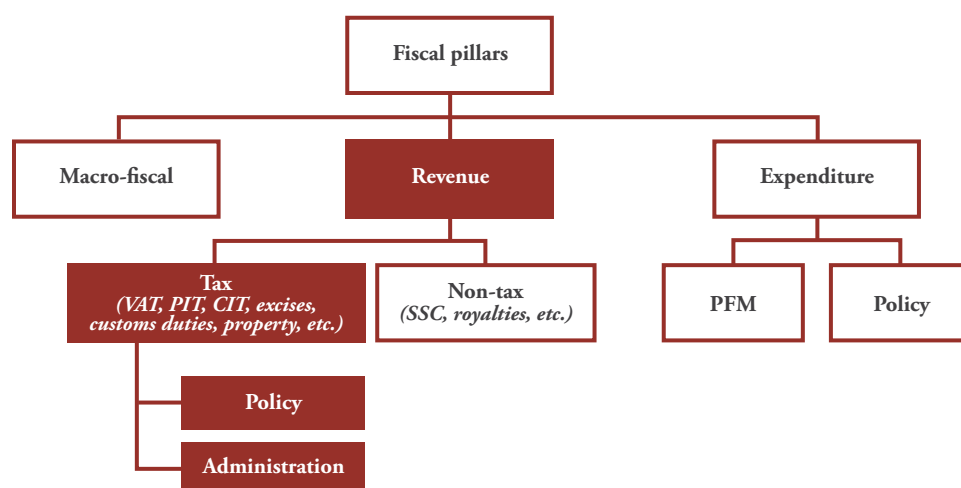
Since 2007, the Bank has revamped its organizational structure and developed a significant fiscal portfolio. In line with the absence of strategic vision, for most of its existence until 2006, TPA did not have a specific home in the Bank.<sup>4</sup> In 2006 the Bank realigned its structure and created a dedicated unit for fiscal issues, the Fiscal and Municipal Management Division (FMM). Most of the Bank's TPA operations are concentrated in FMM, although other units occasionally undertake projects that affect tax issues. For instance, the Integration and Trade Sector (INT) generally leads projects that affect tax collection at the border. In the decade since 2007, the Bank has approved 150 "fiscal" loans for US\$15.1 billion—equivalent to 15% of total approved sovereign-guaranteed lending. Two-thirds of these operations included TPA components.

Given the expansion of the TPA portfolio and the recent fiscal deterioration in the region, the time is ripe for an evaluation of a decade of IDB work on TPA. This evaluation is timely for several reasons. First, greater demand for IDB financial and technical support is to be expected in the context of the slowdown in economic growth since 2012, weak commodity prices, and deterioration of fiscal accounts. Second, the Office of Evaluation and Oversight (OVE) last reviewed fiscal issues in 2008 (RE-317-2), and since then the Bank's structure has been reshaped and its work in the field has expanded significantly.

This evaluation assesses the relevance, implementation, and effectiveness of IDB's TPA interventions since 2007. It focuses on the revenue side of public finance, and does not assess Bank support to enhancing public financial management (PFM), the quality and composition of public spending, or macro-fiscal issues (Figure 1.1). Also, the report covers only the tax portion of total fiscal revenue, thus excluding social security contributions (SSC) and non-tax revenues (such as royalties arising from the exploitation of natural resources).<sup>5</sup> To contextualize the analysis of Bank's work, OVE first reviews the relevant literature in TPA (Chapter II) and the main challenges in taxation in the region (Chapter III). The main findings are concentrated in Chapters IV and V. To assess the relevance of objectives, OVE reviews the key characteristics of the tax portfolio approved between 2007 and 2016 (Chapter IV). To assess the relevance of design, implementation, and effectiveness, the evaluation focuses on seven country case studies and looks at, among other things, the extent to which progress has been made towards the expected results, and the elements that determine effectiveness (Chapter V).

The evaluation combines the identification and desk review of the Bankwide TPA portfolio with an in-depth analysis of the IDB's role in seven countries. Given the multisectoral nature of fiscal issues, a first contribution of the evaluation is

to identify the universe of projects with tax components and to draw Bankwide conclusions about it. The portfolio review covers all operations with tax policy and/or revenue administration components approved during 2007-2016. The portfolio consists mostly of projects led by FMM, but also includes projects prepared by the Institutional Capacity of the State Division, the Capital Markets and Financial Institutions Division, INT, and other Bank units with components aimed at increasing tax revenues. The portfolio analysis is followed by seven case studies that assess the Bank's implementation and effectiveness in different contexts. The case study countries (Colombia, Guatemala, Honduras, Jamaica, Mexico, Paraguay, and Uruguay) represent a balance among different levels of development, tax burdens, and geographic regions, and account for a sizable share of Bank lending engagement (54% of lending and 37% of the total number of loans with TPA components). Only one country with a significant TPA program (Brazil) was not the subject of in-depth case study, because its umbrella program (PROFISCO) has already been evaluated (RE-482-1).



**FIGURE 1.1**

**Fiscal pillars and evaluation scope**

Brown cells illustrate areas covered in this evaluation





2

Precisely because taxes can create distortions in economic behavior, policymakers may use tax policy to affect the prices of specific activities. Conversely, tax policy can also be used to subsidize goods and services with positive externalities, such as investment in research and development.

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# 2 Conceptual Framework

**The primary purpose of taxation is to raise revenue to finance government expenditure. Sufficient tax revenue must be raised to finance the public expenditures that are crucial for growth, including spending on health care, education, and infrastructure. Thus, the ideal tax system can be defined as one that raises essential revenue (as defined by the sufficiency principle) without resorting to unsustainable government borrowing, and without hampering economic activity (as defined by the neutrality principle) (Tanzi and Zee 2001).**

In addition to generating revenue, taxation can be used to correct or mitigate market failures, particularly externalities. Precisely because taxes can create distortions in economic behavior, policymakers may use tax policy to affect the prices of specific activities. Often-cited examples are taxes on fossil fuels—levied to compensate for the cost of pollution—and excise taxes on cigarettes and alcohol, imposed to compensate for public health costs. Conversely, tax policy can also be used to subsidize goods and services with positive externalities, such as investment in research and development (Atkinson and Stiglitz 1976).

Taxation can also be used to promote particular goals, such as directing investment into specific sectors. Governments may have a preference for sustaining or expanding a specific economic sector for strategic (e.g., agricultural production) or economic (e.g., infant industry argument) reasons (Melitz 2005; Slaughter 2004). For example, by increasing the domestic price of imported goods, tariffs can potentially favor local industries. Similarly, tax holidays, investment tax credits, and depreciation allowances are common policy tools to stimulate private investment—although their effectiveness is open to debate.

A strand of the literature also calls for the use of taxation to redistribute income and wealth, although there is general agreement that spending policies are more effective to achieve this goal. In recent years, the role of taxation in income distribution has



returned to the center of the policy and research agenda (e.g., Diamond and Saez 2011; Atkinson 2015; Piketty 2014). Yet much of the literature (Prasad 2008; Cubero and Vladkova Hollar 2010) has emphasized that spending programs constitute the most effective instrument for income redistribution. In their view, the primary contribution of taxation to reducing income inequality is through its financing of redistributive spending measures. Tax policies—the argument goes—are more limited than spending programs because they cannot directly increase the income of poor people, though they can certainly reduce the income of the rich. Moreover, given that income and wealth taxes tend to play a relatively small role in developing countries (de facto affecting wage income earners in the formal sector) and that there are complexities associated with the political economy of tax reforms, developing countries may be in a weaker position to use taxation to redistribute income (Bird and Zolt 2003).

Regardless of the specific goals pursued, any tax reform strategy should consider the long-term implications for the equity and economic efficiency of the tax system. Even though there is no unique prescription, to the extent possible, tax systems should generate revenue in a fair and non-distorting way. If a tax is perceived as unfair, noncompliance pressures are likely to increase and the cost of enforcing tax collection will go up.<sup>6</sup> At the same time, if taxes distort resource allocation significantly, revenues may not materialize as expected.<sup>7</sup>

Equity—typically put into practice through broad tax bases and use of direct taxation—is essential for a tax system to be perceived as legitimate. Horizontal equity (i.e., equal treatment among similarly placed taxpayers) is usually best achieved through broad tax bases; incentives, benefits, and special treatments (which give rise to “tax expenditures”<sup>8</sup>) reduce the tax burden for certain groups or sectors and, all other things being equal, create inequities among taxpayers in similar conditions. Vertical equity (i.e., requiring taxpayers with a greater contributive capacity to pay more) is best pursued through direct taxes, especially through the redistributive effects of progressive individual income and wealth taxes. Indirect taxes, such as the value-added tax (VAT), are considered regressive because lower-income taxpayers tend to spend a larger proportion of their income on them. However, the progressiveness or regressiveness of a tax system ultimately depends on the structure of the taxes. For instance, in LAC countries, several personal income tax (PIT) deductions benefit only higher-income groups and have negative repercussions on equity (Barreix, Bès, and Roca 2009). Also, even a regressive tax that finances services directed at the poorest taxpayers (health, education, etc.) can have positive overall effects on equity.

Economic efficiency calls for tax structures that minimize distortions on consumption, the use of labor, and saving and investment decisions—which implies simple tax systems with few exemptions. By altering relative prices, virtually every tax introduces a distortion in the economy that can ultimately affect economic growth. Special treatments, deductions, and exemptions create a multiplicity of relative prices for different taxpayers, compounding disincentives and distortions. Taxes should therefore be simple, tax bases should be as broad as possible (Mirrlees et al. 2010), and rates should be the lowest

possible to collect a given amount of revenue. Overall, the most conclusive empirical evidence for advanced and developing countries suggests that taxes on income are particularly harmful to growth, while taxes on consumption and property are less so (Arnold 2008; Arnold et al. 2011; Acosta-Ormaechea and Yoo 2012).

The design of taxes must also be compatible with administrative capacity: “the best tax policy in the world is worth little if it cannot be implemented effectively” (Bird and Zolt 2003). Tax authorities’ administrative capacity determines the extent to which they can deter evasion and ensure compliance. Noncompliance is problematic not only because of losses in revenue, but also because it distorts competition (putting the noncompliant at an advantage) and compromises equity (IMF 2015). Simpler tax systems managed by tax agencies with sufficient qualified staff, with adequate systems and equipment, and free of political interference, are usually considered best practices. There is evidence that nonpecuniary incentives to encourage voluntary compliance (“tax morale”) can also have an important policy role (Torgler, Schaffner, and Macintyre 2007; Luttmer and Singhal 2014).

Trade-offs among equity, economic efficiency, and administrative simplicity imply that there is no unique, universal prescription for the design of a good tax system. Different combinations of tax rates and bases can lead to similar tax burdens, and countries need to balance costs and benefits. For instance, while the goals of economic efficiency favor the VAT over the PIT, and for broadening tax bases, equity goals favor the PIT over the VAT, along with excluding from the VAT base items that poor people consume most. Decisions over how to balance those trade-offs depend on societal preferences, the structure of the economy, and the enforcement capacity of the revenue administration. That said, a compromise between efficiency and equity can be achieved through a tax system with a uniform VAT rate (with minimum exemptions); income taxes with broad bases, few brackets, and increasing marginal rates; a tariff system with low rates; reliance on property taxes where possible; and some excises.

A final consideration in the design of tax systems is the political economy of reform processes. Tax reform is as much a political process as it is an economic endeavor (Santos de Souza 2013). The literature identifies many political constraints that affect governments’ ability to carry out tax reforms, including external factors and crises, electoral support and political legitimacy, partisan alliances, and elite influence. For example, crises can create windows of opportunity for reforms (Tanzi 2000; Lora 2007; Bonvecchi 2010), while lack of political legitimacy can undermine reform attempts. In any case, even under the best scenario, a solid tax reform is not a sufficient condition for a tax system to be improved. Other elements, such as well-targeted government expenditures, strong institutions (e.g., the judiciary), and mechanisms to prevent wrongdoing (e.g., corruption), need to be in place. In this last regard, corruption adds a dimension of complexity to the already complex political economy, especially when interests are too concentrated in a small group of taxpayers. Finally, reforms at the subnational level face their own political economy challenges, usually associated with the closeness of local politicians to their constituencies.



During the last decade - and despite some rebound during the financial crisis - noncompliance has been reduced in many LAC countries.  
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# 3 Tax Systems in Latin America and the Caribbean<sup>9</sup>

**Despite regional diversity, tax systems in most LAC countries share certain characteristics and face similar constraints. This chapter summarizes the main facts about the region's tax systems. The chapter necessarily falls into some degree of generalization, but references to countries and subregions help illustrate the regional heterogeneity.**

## **A. TAX REVENUE: BOOSTING REVENUE TO FINANCE EXPENDITURES**

Since the 1990s, tax structures in LAC have undergone significant changes, generally with the aim of raising government revenue as part of broader reform programs. LAC debt crises in the 1980s highlighted the importance of increasing revenue to close structural fiscal gaps and finance social safety nets. At the same time, there was an effort to liberalize and open LAC economies. The centerpiece of a first generation of tax reforms was the VAT, which was consolidated as the region's main tax as it was less distortionary and more effective for raising revenue. Liberalization and trade openness were pursued through an overall reduction of trade taxes and a widespread reduction of corporate income tax (CIT) rates.

Overall, though the region has reduced the number of taxes, new “heterodox” taxes—easy to collect but arguably distortionary—have emerged. The region has experienced a reduction in the number of taxes since the 1990s (mainly because of a decrease in selective taxes), which was balanced with the appearance of “heterodox” taxes applied to unconventional bases, such as those on financial services and exports. In comparison, the PIT and the property tax underwent fewer and milder reforms. The bias toward easier-to-collect taxes (e.g., consumption vs. income taxes) and “heterodox” taxes was arguably a by-product of limited administrative capacity.

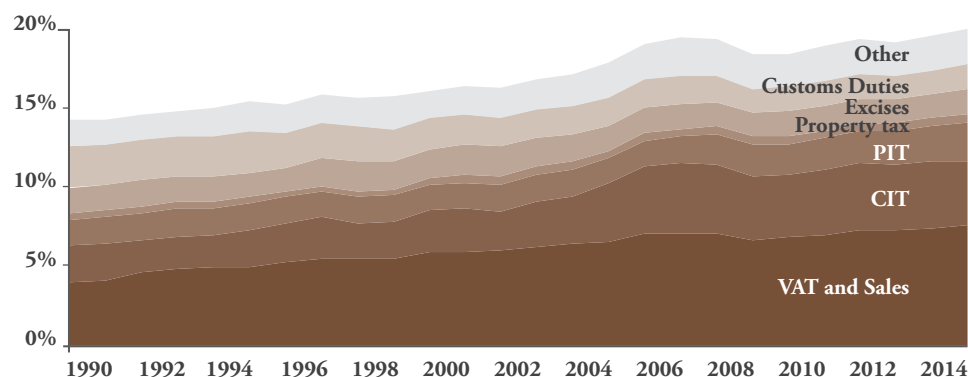


Tax administration reform was more dynamic, and most tax agencies in the region underwent a process of operational (e.g., HR, IT) and institutional modernization (e.g., autonomy). Specific measures ran the gamut from the organizational and administrative changes required for the effective administration of the VAT to the creation of specialized units to monitor large taxpayers, the development of IT systems, and, in several countries, the granting of operational and financial autonomy to revenue administrations. This last measure led to the creation of autonomous or semi-autonomous revenue agencies integrating tax and customs (Colombia, Guatemala, Mexico, and Venezuela)<sup>10</sup> and, in some cases, also the collection of SSCs (Argentina, Brazil, and Peru). Moreover, an increased awareness of the impact of informality on tax revenue caused some countries to adopt simplified systems to tax small taxpayers.

Since 2007, structural tax reforms have been less common, while partial reform efforts have placed greater focus on equity, economic efficiency, and the effectiveness of revenue collection agencies. Even after the implementation of the initial wave of reforms, income remained undertaxed, tax exemptions and distortionary taxes remained significant, and large compliance gaps persisted. Over the last decade, most countries in the region addressed these shortcomings through a second generation of reforms aimed at balancing the trade-offs—mainly through incremental modifications rather than comprehensive TPA reforms.<sup>11</sup>

Between 1990 and 2015, LAC's tax burden increased more than that in any other region in the world, partly because of these reforms. Despite having started from a low baseline, the region's tax-to-GDP ratio (excluding revenue from SSC and natural resources) increased from 13.6% to 19% between 1990 and 2015. The trend of increasing revenues was seen in virtually every country in the region, regardless of income level or geographic location. The increase in revenue was generally driven by the VAT and CIT (Figure 3.1).<sup>12</sup> Interestingly, tax revenue growth has outpaced per capita income growth—evidence of the greater fiscal effort demanded of LAC country citizens over the past decades (Barreix, Benítez, and Pecho 2017). The share of taxes in total fiscal revenue has also increased, from 55% in 1996 to 68% in 2015.<sup>13</sup>

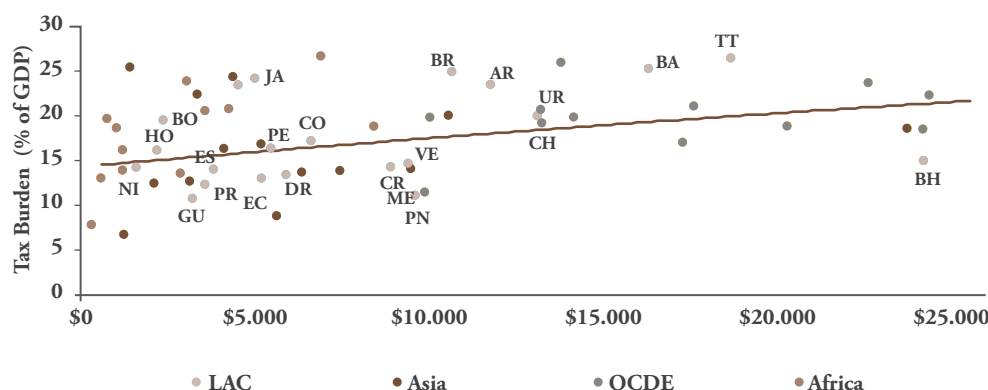
However, significant heterogeneity persists among LAC countries, and tax revenues in several countries are still too low to support growth-enhancing expenditures.<sup>14</sup> Since tax revenue is usually positively associated with per capita income, it is not surprising to find wide variation across countries. For instance, although several countries have tax burdens equal to those of Organisation for Economic Co-operation and Development (OECD) countries (e.g., Argentina, Brazil, and Uruguay), others (e.g., El Salvador, Guatemala, and Paraguay) have levels that are well below the minimum needed to support sustainable GDP growth (IMF 2016).<sup>15</sup> In these countries, insufficient revenue arguably limits the governments' capacity for spending on social programs and infrastructure. Indeed, several countries—especially in Central America—have tax burdens that are low for their income levels (Figure 3.2).



**FIGURE 3.1**  
Level and composition of  
tax burden (% of GDP) in  
LAC, 1990-2015

Source: OVE calculations based on Revenue Statistics in Latin America, (OECD/ECLAC/CIAT/BID 2017).  
Note: Includes tax revenue for all Government levels.

Tax revenues in LAC are far from reaching their potential, particularly at the subnational level. Most countries exhibit gaps between actual and potential revenue (Fenochietto and Pessino 2013; Figure A.3.1) not least because of the combination of high tax rates and narrow tax bases, coupled with challenges in revenue administration—including low compliance due to significant informality. Subnational governments are particularly far from reaching their potential in terms of revenue, as the decentralization process started in the 1990s focused on public expenditure, rather than revenue.<sup>16</sup> In fact, despite an ever-increasing share of subnational spending in total public expenditure, the percentage of own revenue collected by subnational governments has remained unchanged (Box A.3.2). To a large extent, this stems from the fact that local governments have fewer incentives to tax their own constituencies and prefer to rely on transfers from the central government; income from natural resources is a significant source of revenue in LAC and is one of the main source of financing for local governments.<sup>17</sup> Since local governments' main tax, the property tax, is relatively non-distortionary and equitable, an increase in revenues at the subnational level is a desirable policy outcome.



**FIGURE 3.2**  
Average tax burden and per capita  
income, 2007-2015

Source: OVE based on OECD (2017) "Revenue Statistics in Latin America, OCDE, Asia and Africa: Comparative tables", IMF (2016) "Government Finance Statistics", and IMF (Oct 2016) "World Economic Outlook".  
Note: Includes tax revenue for all Government levels (Federal, State and Local), excluding Social Security Contributions, Social Security Funds, and revenue from natural resources. Data for LAC and OCDE is average from 2007-2015 and data for Africa and Asia is average from 2007-2014, except for Australia, Japan, Poland, Netherlands, Korea, Indonesia, Malaysia, China and Mongolia (2007-2013); Cabo Verde (2008-2009); Congo and Yemen (2007-2012); Tanzania (2013); Iran (2007-2009); Jordan (2008-2013); Timor-Leste (2010-2013). In the case of Bolivia special tax on hydrocarbons, excise tax on hydrocarbons and derivatives and fiscal notes are excluded.



## B. EQUITY: INCREASING THE DISTRIBUTIONAL IMPACT OF TAXATION

Countries' high and increasing dependence on indirect taxation has taken a toll on the equity of tax systems in the region. Over the review period, VAT revenue collection continued to increase, reaching the level of OECD countries (Table 3.1).<sup>18</sup> The increase in PIT receipts was more moderate—its growth trend since 2007 was surpassed by all other major taxes—and, on average, PIT makes up only 11% of total tax revenue and about 2.3% of the region's GDP. This represents about a third of the receipts of the VAT, and a fourth of the average OECD countries raise relative to GDP.

TABLE 3.1. TAX BURDEN AND BREAKDOWN (% OF GDP), 2015e

		OECD	LAC
<b>Direct</b>	<b>Income and wealth</b>	<b>13,89</b>	<b>7,20</b>
	CIT	2,90	3,89
	PIT	8,69	2,31
	Property	1,50	0,50
	Other <sup>/1</sup>	0,80	0,50
<b>Indirect</b>	<b>Goods and Services</b>	<b>11,20</b>	<b>11,80</b>
	Sales, VAT, turnover	7,00	7,20
	Excises	2,60	1,50
	Import	0,10	1,50
	Export		0,10
	Other <sup>/2</sup>	1,50	1,50
	<b>Total Tax burden<sup>/3</sup></b>	<b>25,1</b>	<b>19,0</b>

Source: OVE based on OECD (2017) "Revenue Statistics in Latin America, and OCDE: Comparative tables."

Notes: <sup>/1</sup> Taxes on payroll and workforce (exc. SSC and other contributions) and taxes on financial and capital transactions.

<sup>/2</sup> Other taxes on goods and services and other taxes.

<sup>/3</sup> Includes tax revenue for all Government levels (Federal, State and Local) and excludes Social Security Contributions, Social Security Funds, and revenue from natural resources.

Tax systems in LAC continue to have a limited redistributive role, which relies almost entirely on public spending. Even though the structure of PIT is progressive in most LAC countries, the fact that it is paid almost exclusively by formal high-wage-earning individuals at the top of the income distribution (Barreix et al. 2017) limits its capacity to raise revenue. CIT continues to be more important than PIT in the region, and its redistributive effect is unclear as firms can pass the burden on to consumers (Gómez-Sabaini, Jimenez, and Rossignolo 2012). As a result, redistributive policy in LAC relies almost entirely on public spending (Lustig 2016; World Bank 2013).

During the last decade, changes to income taxes have been the most common tax policy modification in LAC, aimed at increasing their contribution to revenue. In the context of second-generation tax reforms in LAC, the Bank supported parametric

changes to the tax rates and/or tax bases, aimed at increasing the contribution of direct taxes to total tax revenue and enhancing the design of brackets and exemptions. Some countries carried out deeper reforms, such as the introduction of dual or semi-dual tax systems following the experience of Scandinavian countries (Uruguay in 2007, Peru in 2009, and Central American countries thereafter) (Box A.3.3).

### *Box 3.1. Indicators for equity, economic efficiency, and administrative effectiveness*

Finding comparable measures of equity, economic efficiency, and administrative effectiveness is fraught with difficulties, especially given the lack of comparable data for all of IDB's borrowing member countries. Although each dimension could be measured by multiple indicators, OVE constructed indicators that maximized comparability. As happens when comparing indicators across countries, OVE's indicators do not capture the nuances of how tax systems work in different country contexts. However, they are useful to illustrate tendencies and changes over time. Secondary indicators were used to confirm results (see the table below, as well as Box A.3.4 and Annex II).

For equity, the selected indicator is the share of taxes that are more “equitable” in terms of their income redistribution implications (PIT + property tax). A secondary measure was the Reynolds-Smolensky Index for the PIT, which quantifies the extent to which inequality has been reduced because of the PIT.<sup>a</sup> Because redistribution is likely to be achieved more effectively through the expenditure side of the budget, this indicator does not attempt to capture the equalizing effects of the whole fiscal system, but rather to illustrate tendencies in each country's tax system. Following the literature and FMM's Fiscal Policy Quality Index, economic efficiency is measured by an index of the relative importance of distortionary taxes. Finally, effectiveness of revenue administration is mostly captured by VAT noncompliance relative to potential revenue. Restricting the noncompliance measure to the VAT has some limitations, but is appropriate since the VAT is the major tax in the region and data are available for many countries.

#### INDICATORS FOR EQUITY, ECONOMIC EFFICIENCY, AND ADMINISTRATIVE EFFECTIVENESS

Dimension	OVE main indicator	Complementary indicators
Equity <sup>b</sup>	PIT + taxes on property (% Tax Revenue)	Reynolds-Smolensky Index (PIT)
Economic efficiency	[General taxes (VAT + sales taxes) + excises + taxes on specific services + taxes on property] / [taxes on income, profits, and capital gains + SSC + customs and Import duties + taxes on exports + other taxes on international trade and transactions + taxes on financial and capital transactions]	Tax expenditures (% GDP)
Effectiveness	VAT noncompliance (as % of potential revenue)	VAT stop filers (%)

Notes: <sup>a</sup>Following the OECD/ECLAC/CIAT/IDB's “Revenue Statistics in Latin America and the Caribbean, 2017,” the PIT includes taxes on income from labor sources, profits, and capital gains.

<sup>b</sup>This evaluation focuses mostly on vertical equity.

As measured by OVE's selected indicators (Box 3.1), most countries in LAC show advances in terms of equity since 2007 (Figure A.3.2). The increased prevalence of direct taxes has enhanced the progressivity and redistribution of tax systems, especially in South America.<sup>19</sup> Moreover, direct taxes have been shown to reduce inequality, on average, by 0.4–0.8 GINI points (Cornia 2011).

### **C. ECONOMIC EFFICIENCY: REDUCING THE DISTORTIONARY EFFECTS OF TAXES**

Tax systems in LAC continue to exhibit significant tax expenditures—estimated at 3.8% of GDP, or 20% of total tax burden—and some countries display an increasing dependence on “heterodox” taxes. Non-evaluated and often redundant fiscal incentives and preferential treatments for certain taxpayers and sectors are extensive in the region. At present, 88% of the countries in the region provide some sort of tax exemption (IDB 2016), eroding the tax base (particularly in the case of the income tax) and causing additional distortions in the choices made by taxpayers. Moreover, highly distortionary taxes (e.g., financial transaction, export duties), which generate quick revenue, represent as much as 5% of total tax revenue in Argentina, Brazil, Colombia, and Venezuela (IDB 2013).

In the last decade, there have been numerous attempts at quantifying tax expenditures and eliminating distortionary taxes. In some countries (e.g., Guatemala, Jamaica, Mexico), there have been significant efforts to measure tax expenditures and to increase budgetary transparency. In tandem, there were attempts to eliminate old, distortionary taxes, introduce limits on tax expenditures, and begin a reversal of the bias against income taxes. For example, several countries abolished the financial transaction and the border adjustment taxes.<sup>20</sup>

Progress toward increasing the efficiency of tax systems has been uneven (Figure A.3.3), often highlighting the policy trade-offs between economic efficiency and equity. The most significantly positive changes (reforms that resulted in the largest improvements in economic efficiency) were in Chile, Jamaica, Panama, and Peru, and were consistent with the policy choices of reducing exemptions, simplifying the tax system, and strengthening the VAT. At the same time, Uruguay enacted a reform whose main purpose was to increase equity (increasing the relative importance of the PIT, a distortionary tax).

### **D. ADMINISTRATIVE EFFECTIVENESS: LOWERING NONCOMPLIANCE**

Noncompliance remains the main problem for tax systems in LAC, and the task of quantifying its extent is largely pending. Only a few countries in the region (Chile, Mexico, Peru, Uruguay) consistently measure and publish noncompliance figures (commonly known as *evasion*), although many other LAC countries have made

progress in recent years. On average, it is estimated that Latin American countries forgo 6.3% of the region's GDP because of evasion and tax expenditures (ECLAC 2016)—more than a third of the regional average tax collection. As for the PIT, on average over 50% of revenue is forgone because of noncompliance, with values as high as roughly 70% in Guatemala and 58% in Ecuador. VAT noncompliance is less marked, but it remains significant, with rates ranging from about 20% in Argentina, Chile, Colombia, Ecuador, Mexico, and Uruguay to more than 50% in Haiti.

Over the review period, significant efforts have been made to improve compliance by reforming the organizational structure of tax agencies and advancing in the use of information technology (IT). Almost all LAC countries created semi-autonomous collection agencies, incorporated more qualified human resources, created “large taxpayer units,” and began to use comprehensive computerized systems. With the advance of new IT, many countries implemented e-filing, e-payment, and regimes for withholding at the source and for capturing information from external sources (“third-party”). Concerning domestic taxes, the most significant development was the widespread adoption of electronic invoicing, which started in Chile in 2003 and was subsequently introduced in over 10 countries in the region.<sup>21</sup>

During the last decade—and despite some rebound during the financial crisis—noncompliance has been reduced in many LAC countries. Of the 10 countries for which data are available, only Costa Rica has been unable, at least until 2012, to reverse the increase in noncompliance experienced in 2009. In all other countries, the 2008-09 international crisis pushed evasion up only temporarily, and noncompliance rates are currently lower than they were a decade ago.



The Bank approved US\$11.2 billion in lending projects with tax components over the last decade—equivalent to roughly 12% of total sovereign-guaranteed Bank lending during the period.  
© IDB

# 4 IDB Support to Tax Systems

As was mentioned earlier, with the 2006 Realignment the Bank consolidated its public-sector reform portfolio in a single department; more recently, it developed its first operational guidelines for fiscal projects.<sup>22</sup> In the context of the 2006 Realignment, the FMM division was created under the Institutions for Development Sector, giving fiscal matters an institutional home. Yet it was only recently that the Bank developed operational guidelines (Sector Framework Documents, or SFDs) for fiscal matters. The Bank developed the Decentralization and Subnational Governments SFD (GN-2813-4) in 2015 and the Fiscal Policy and Management SFD (GN-2831-3) in 2016. Among other topics, these SFDs proposed to focus on improving the design of tax systems, modernizing and increasing the effectiveness of tax administrations (e.g., through promoting electronic invoicing and data cross-referencing), and enhancing coordination across government levels (Box 4.1 and Annex III).

## A. TAX PORTFOLIO AT A GLANCE

In terms of operations, IDB support to TPA is embedded in a broader fiscal portfolio, in which the Bank has combined tax work with public expenditure management and macro-fiscal issues. Given the multisectoral nature of fiscal matters (Table A.4.1), OVE first identified the universe of projects that tackle macro-fiscal, tax, and (nonsectorial) expenditure issues (Box A.4.1 and Figure A.4.1). Since 2007, the Bank has approved 150 “fiscal” loans for US\$15.1 billion—equivalent to 15% of the Bank’s total sovereign-guaranteed lending. A large majority of these loans originated in FMM and had a significant degree of overlap among the three fiscal pillars. In fact, nearly one-third of



the portfolio touched on TPA, PFM, and macro-fiscal pillars simultaneously (Figure 4.1). The quality and composition of expenditures, including the assessment of possible contingent liabilities, has played a minor role in the identified portfolio.

#### **Box 4.1. Sector Framework Documents: Key points**

In the context of the “Strategy for Institutions for Growth and Social Welfare,” the Bank prepared two SFDs that tackle tax policy and administration issues.

The Fiscal Policy and Management SFD (GN-2831-4, 2016) identifies the Bank’s main goal in the sector as promoting fiscal policy management that fosters robust, stable, sustainable, and equitable growth. In tax policy, one of its main lines of action is to “improve the structural design of tax systems, placing emphasis on their neutrality, adequacy, simplicity, and progressivity.” In tax administration, key lines of action include the institutional and technological modernization of tax administrations, the strengthening of institutional capacity in international taxation matters, and the promotion of the use of technologies for administration and cross-referencing of mass data to detect and prevent tax evasion. This SFD also considers the importance of taxation at various levels of government, by setting actions to “improve coordination in the allocation and demarcation of functions among the various levels of government regarding taxation powers.”

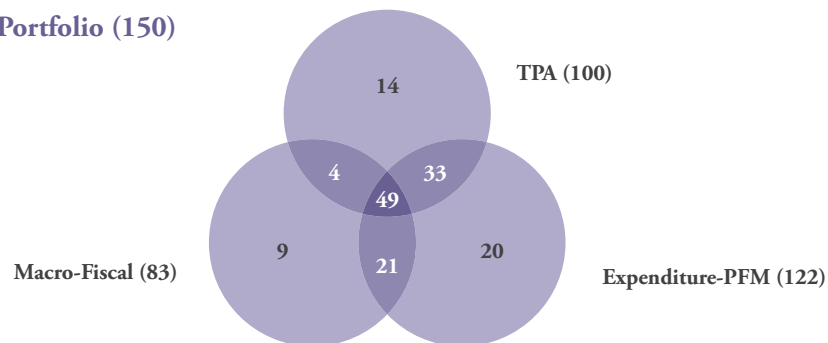
The Decentralization and Subnational Governments SFD (GN-2813-3, 2015) further elaborates on the Bank’s goal to promote more effective and efficient subnational management in LAC, tackling multiple issues, including revenue collection capacity at the local level. (Annex III provides further details.)

**FIGURE 4.1**  
**Number of loans in the fiscal portfolio by pillar**

*Source:* OVE, based on IDB Data Warehouse.

*Note:* Venn diagram not drawn to scale. Inner diagram count adds up to the 150 loans analyzed. Outer count for each pillar shows the number of loans that include at least one component under that pillar.

#### **Fiscal Portfolio (150)**



Between 2007 and 2016, the Bank approved 100 loans with TPA components (hereinafter the “TPA portfolio”) and 50 TCs.<sup>23</sup> The Bank approved US\$11.2 billion in lending projects with tax components over the last decade—equivalent to roughly 12% of total sovereign-guaranteed Bank lending during the period (Table 4.1)—with lending tending to increase in times of macroeconomic imbalances (Figure A.4.2). The bulk of the financial support for tax issues (80%) has been provided through PBLs, although most loans were investment projects (58%). Most TCs supported PBLs, but

the portfolio also encompassed stand-alone TCs—including one aimed at fostering horizontal cooperation between countries (TC-INTRA) on revenue administration. Though highly concentrated, the TPA portfolio covers 20 of the 26 IDB borrowing countries (Figure 4.2).

TABLE 4.1. PORTFOLIO SNAPSHOT, 2007-2016

		All Fiscal	Of which TPA*
<b>Loans</b>	# Operations	150	100
	% of # of SG loans	14,9%	10,0%
	US\$ Billion	US\$ 15.1	US\$ 11.2
	% of SG lending	15,5%	11,5%
<b>TCs</b>	# Operations	191	50
	% of # of TCs	8,3%	2,2%
	US\$ Million	US\$ 94.6	US\$ 19.2
	% of US\$	9,6%	1,9%

Source: OVE based on IDB Data Warehouse.

Note: \* Includes tax-related and other components.



FIGURE 4.2

**IDB Support to TPA**  
Number of loans by  
country, 2007-2016

More financial support for tax reforms was approved for countries with relatively lower income and tax burdens. In terms of GDP, Bank lending through loans with TPA components has been larger in countries with lower per capita income and, given the positive relationship between tax revenue and GDP, lower revenue capacity, especially

in Central America (Figure 4.3).<sup>24</sup> In absolute terms, lending amounts have been concentrated in Brazil, Mexico, and Colombia (Table A.4.1). These three countries account for two-thirds of the TPA portfolio and have received significant technical support from the IDB, including assistance for the design and implementation of electronic invoice systems for tax collection.

Much of the Bank's work has focused on the subnational level—especially in South America—typically as part of a strategy to boost property tax receipts and decrease reliance on central government transfers. Besides Brazil, which had a dedicated program for subnational fiscal support entitled PROFISCO (Box 4.2), the Bank worked in 10 countries at the subnational level during the review period. This means that more than half the number of TPA loans approved (and 35% of the approved amounts) supported subnational entities—usually addressing revenue issues in provinces or states (Figure A.4.3)—and this tendency increased over time.<sup>25</sup> In general, most of this work has centered on strengthening institutional capacity (including modernizing property cadasters). TCs and knowledge products also involved significant work at the subnational level. The Bank's emphasis has been pertinent because enhancing the fiscal capacity of subnational governments strengthens fiscal decentralization, and also because a higher reliance on property taxes translates into more equitable and relatively less distortionary tax systems.

#### ***Box 4.2. Subnational Fiscal Management in Brazil***

The Bank's work on subnational fiscal management is illustrated by the *Programa de Apoio a Gestão e Integração dos Fiscos* (PROFISCO) in Brazil. After supporting subnational fiscal management through the federal government with the PNAFE between 1996 and 2007 (BR0171), the Bank created the PROFISCO Credit Facility (BR-X1005), approved in November 2008, to support the modernization of fiscal and financial management in the Brazilian states. Under the PROFISCO CCLIP, 27 loans for a total of US\$641 million were approved.

PROFISCO projects have a standard structure, with four components on integrated strategic management, fiscal management and tax disputes, financial and asset management, and strategic resource management (HR, IT systems). All projects approved under the PROFISCO credit line are required to ensure implementation of the National Synchronized Cadaster and digital public accounting system (SPED), consisting of SPED Contábil, SPED Fiscal and Nota Fiscal Eletrônica (electronic fiscal invoice).

The PROFISCO program has helped to disseminate lessons and good practices in tax administration in LAC. The introduction of the electronic invoice for tax collection and the digital registration of taxpayer information and obligations (“escrituración digital”) has provided important lessons that have been used and adapted to other countries, including Mexico and Colombia.

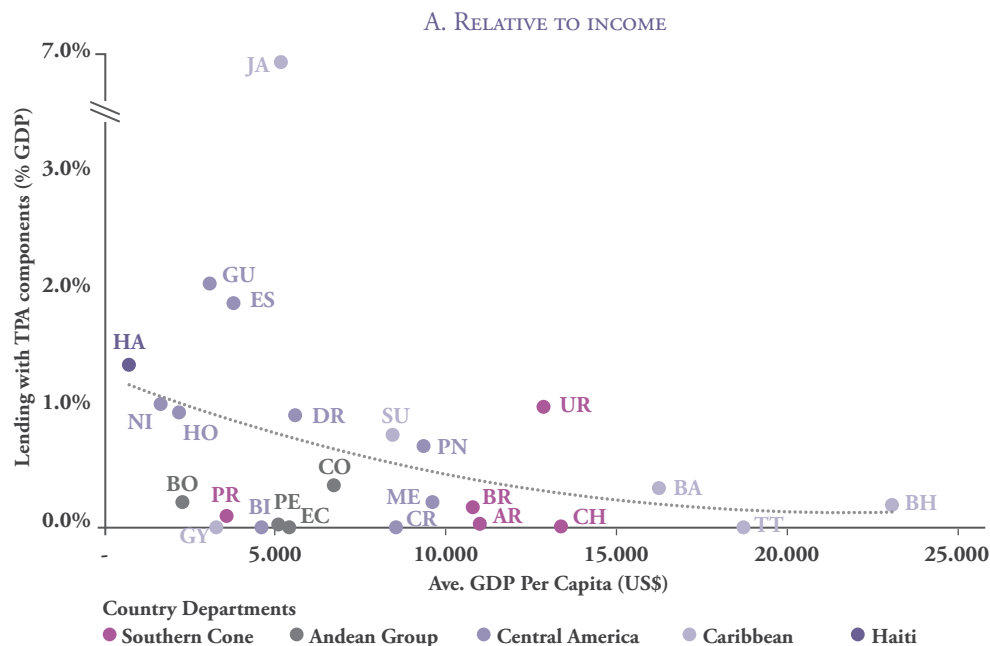


FIGURE 4.3A

IDB support to tax policy and administration, 2007-2016

Source: OVE, based on IDB Data Warehouse and the IMF.

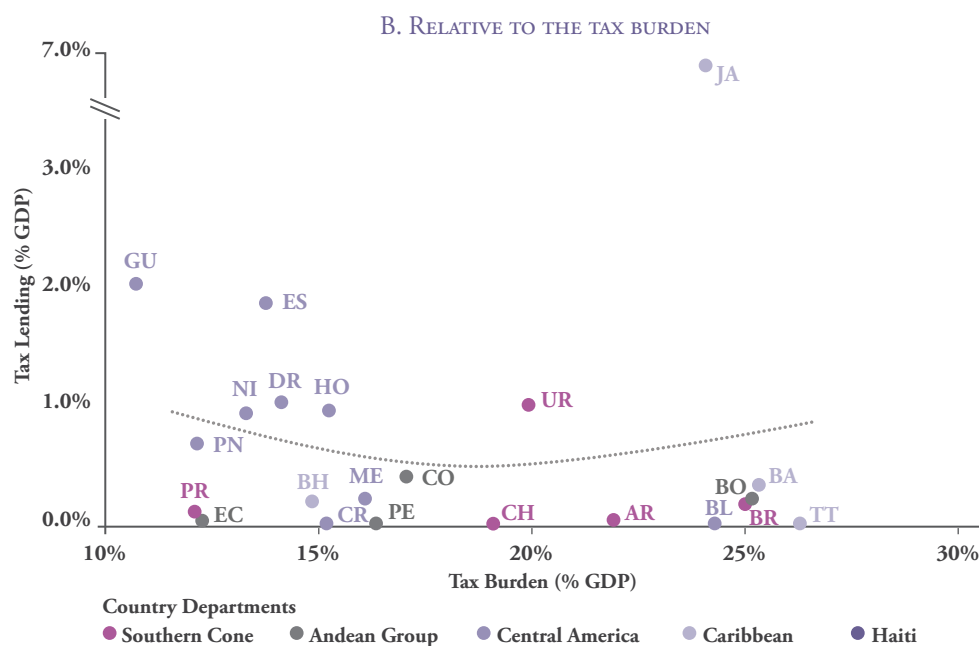


FIGURE 4.3B

Source: OVE, based on IDB Data Warehouse and the IMF.

In addition to its operational contribution, the Bank has increasingly produced a significant volume of knowledge products and has sponsored dissemination activities, consolidating a reputation in taxation. OVE identified 94 fiscal knowledge products in IDB's Repository of Institutional Knowledge—most of them created by FMM and complemented by the Department of Research and Chief Economist (RES) (Box A.4.2).<sup>26</sup> Most knowledge products contain policy-level discussions with direct practical application—for example, on methodological issues on measuring tax expenditures in nearly all countries in the region, and specific fiscal policy

proposals on a variety of issues, from studies on municipal finances to studies on tax transparency. One of the most recognized knowledge products has been the flagship 2013 Development in the Americas Report “More than Revenue.” External parties and clients interviewed considered that the report helped position the IDB as a technical reference for TPA in LAC. In addition, the Bank has produced multiple toolkits and databases on fiscal matters, usually in partnership with the OECD. RES has also contributed to the knowledge agenda over the review period, studying tax compliance from a behavioral economics perspective.

## **B. OBJECTIVES OF THE TAX PORTFOLIO**

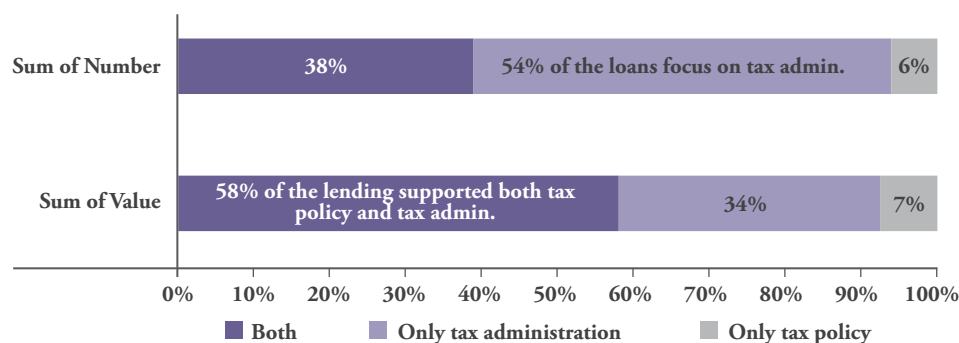
Bank involvement has been primarily aimed at increasing tax revenues as part of an effort to achieve a sustainable or stable fiscal path. OVE reviewed the objectives, components, and areas of work of all 100 loans in the TPA portfolio. Eight of every 10 loans were aimed at increasing tax revenue. As was mentioned earlier, structural tax reforms in LAC have been rare over the evaluation period, so IDB’s involvement was mainly in incremental reform programs.<sup>27</sup>

The portfolio’s main objective of raising revenues has been relevant, particularly as the Bank focused on countries with lower tax burdens. The overall objective of increasing the tax-to-GDP ratio is highly relevant for three reasons. First, because the primary function of a tax system is to generate revenue, it makes sense for the IDB to have focused on ensuring that this function is discharged adequately. Second, countries with tax revenues that are not comfortably above 13-15% of GDP are unlikely to experience sustained economic growth. Third, many of the Bank’s interventions in TPA have taken place after a crisis, aiming to increase revenue to put the public sector’s budget on a more sustainable path and thereby avoid the economic and social costs of macroeconomic distress. Moreover, the portfolio’s objective of increasing revenues has been in line with Bank guidelines: both IDB-9 and the SIGS (which provided the framework for Bank support to TPA during most of the review period) established increasing tax revenues as one of their development goals.<sup>28</sup>

Explicit consideration of trade-offs between revenue and other policy goals has been less frequent, though the equity and efficiency implications of reforms appear to have been implicitly recognized. The share of loans with economic efficiency or equity as explicit objectives has been relatively small.<sup>29</sup> This might reflect the view that redistribution is better accomplished through expenditures than revenues, and that raising revenue is critical to finance spending on social programs even if tax systems themselves are not progressive. Some Bank knowledge products analyzed the equity or efficiency implications of fiscal policy.<sup>30</sup>

The most frequent approach to raising tax collection has been enhancing the capacity of revenue administration agencies. Almost the entire TPA portfolio covered revenue administration work, whereas about half included tax policy issues (Figure 4.4). As

expected, investment loans were primarily used to finance the expenses required for improving tax administration, while PBLs generally supported policy issues (although PBLs also included disbursement triggers on revenue administration). The main topics covered, and their relative importance, are analyzed in Box 4.3 and Figure 4.5.



**FIGURE 4.4**  
IDB Support to policy and administration issues

Source: OVE

On tax policy, the Bank's priority has been the broadening of tax bases—especially through the expansion of the PIT base in Central America, and the review of tax expenditures across LAC (Table 4.2). For instance, the Bank supported capital gains taxation and other tax reforms for individuals (Dominican Republic, El Salvador, Honduras, Mexico, Panama, and Suriname), the introduction of dual or multi-segment tax systems in Guatemala and Uruguay, and the creation of simplified tax systems to fight informality (such as the *monotributo* in Colombia's 2016 reform). Regarding indirect taxes, the Bank has worked toward the reduction of VAT exemptions and zero rates in some countries, including Colombia, Honduras, and Jamaica. Moreover, the Bank made significant efforts to help countries quantify and enhance the transparency of tax expenditures, usually as a first step toward limiting the erosion of tax bases.

The Bank supported the creation of new taxes both to increase revenue and mitigate negative externalities. The Bank supported the introduction of excise taxes, ad-valorem taxes, and “eco-taxes” in several countries, including Dominican Republic, Jamaica, and Mexico. Less often the Bank supported rationalizing the structure of the tax system.

The Bank's work on revenue administration focused on strengthening audit and collection enforcement capacity. The IDB has generally supported audit activities (including risk analysis and data cross-checking aimed at detecting underreporting and selecting taxpayers for audit), followed by collection enforcement capacities (including detection and enforcement with respect to stop filers, collection of tax arrears, and administration of tax registries). Examples range from increasing the audit capabilities of Jamaica's large taxpayers office to recovering tax arrears and updating cadasters in Brazil and in Colombia's municipalities. Moreover, 35 loans in the portfolio included activities related to reducing tax evasion and fraud at customs. Less attention has been given to enhancing tax litigation and appeal procedures.



### Box 4.3. Thematic composition of the tax portfolio

Area		Description of support
Tax policy	Tax base	Broadening tax bases by reducing tax expenditures, measuring tax expenditures, or changing the coverage of an existing tax.
	Tax rate	Changes in the tax rates.
	New / old taxes	Establishment of new taxes and/or the elimination of existing taxes.
Revenue administration (core functions)	Collection	Activities to improve (i) regular collection activities and capabilities, (ii) detection and enforcement of stop filers, (iii) collection of tax arrears, and (iv) administration of tax registries.
	Audit	Improvements in audit effectiveness, including risk analysis and data cross-checking.
	Appeals	Improvements in litigation and appeal processes.
Revenue administration (support functions)	Legal frameworks	Changes in legislation, such as anti-evasion laws.
	Processes & information technology (IT)	Introduction of processes and/or IT infrastructure (hardware and software)—for example, e-filing, e-payments, and also funding for taxpayer services provided via webpages / call-centers.
	Human resources	HR policy reforms, HR management systems, and/or training.
	Organizational reforms	Design and implementation of changes in the organizational structure, including the creation of tax units for controlling large taxpayers.
	Governance	Efforts to increase the transparency, independence, and/or budgetary autonomy of collection agencies.

FIGURE 4.5

### Thematic composition of the tax portfolio

Source: OVE.

Note: The graph represents the share of each area of work in the tax policy and administration portfolio (n=100). A single loan can work in more than one area. Dollar amounts are calculated at the project level, not work area, and are hence duplicated for projects with more than one area of work.

\*29 loans affect tax bases: 16 directly (e.g. reducing tax expenditures) and 13 indirectly (e.g. studies on tax expenditures).

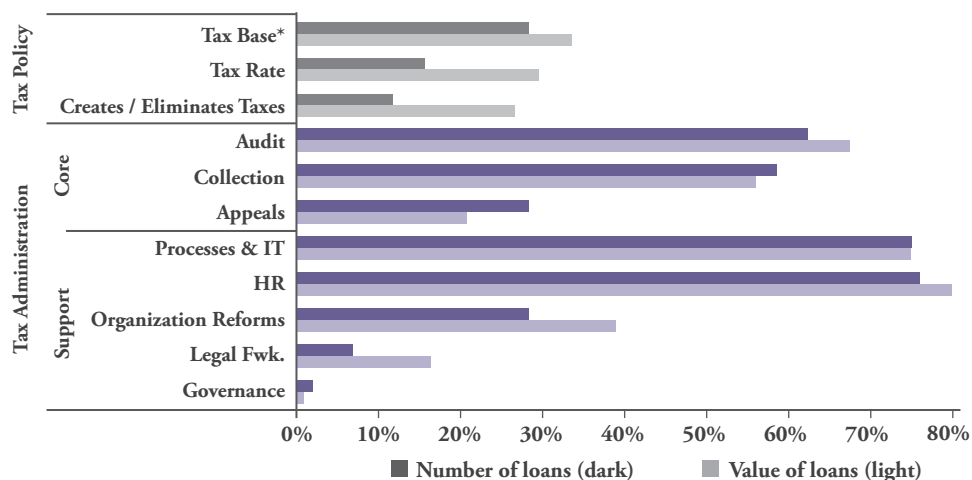


TABLE 4.2 ADJUSTMENT IN PARAMETERS: NUMBER OF COUNTRIES AND LOANS  
(NUMBER OF LOANS IN BRACKETS)

		Tax base	Tax rate		
	Tax	Total <sup>a</sup>	Total	Decrease	Increase
Direct	PIT	9 (12)	3 (4)	1 (2) <sup>b</sup>	3 (4)
	CIT	3 (4)	4 (8)	2 (5)	2 (3) <sup>d</sup>
Indirect	Consumption / VAT	5 (5)	7 (9)	2 (2) <sup>c</sup>	5 (7)
	Excises	-	5 (5)	-	4 (4)
	Stamps	-	1 (3)	1 (3)	-
	Cash deposits	-	1 (1)	1 (1)	-
	International trade	-	1 (2)	1 (2)	-
Other	Unspecified	2 (4)	2 (2)	-	-
	Tax expenditures estimates	7 (13)	-	-	-

Source: OVE, based on Data Warehouse.

Notes: <sup>a</sup> The Bank supported only widening of tax bases.

<sup>b</sup> In Guatemala, the number of brackets under the regime applicable to wage earners was reduced and the tax rates were lowered, depending on the income bracket.

<sup>c</sup> Suriname (for cultural and sports events only) and Uruguay.

<sup>d</sup> Temporary increase in Mexico. In Guatemala, there was an increase in the rate applicable to gross income under the simplified optional regime for businesses and self-employed, while the tax rate on net earnings for businesses was reduced.

In revenue administration support functions, the Bank has financed improvements in IT, human resources, and organizational reforms. Eight of every 10 loans supported reforms in processes, upgrades in IT, or improvements in human capital formation. Examples include the Bank's work with subnational governments in Brazil under the PROFISCO program, with electronic invoicing in Colombia, and with computer systems to monitor compliance in Jamaica. Almost a third of the projects supported longer-term organizational reforms, such as the creation of a tax intelligence unit in Mexico.<sup>31</sup>

Less attention has been devoted to governance and regulatory issues. Assistance to increase the financial and political autonomy of revenue agencies, and to develop guidelines and safeguards to improve organizational integrity and reduce chances of corruption, has been less frequent. Similarly, little emphasis has been placed on developing legal frameworks, such as anti-evasion laws, and strengthening the sanctions and penalties system. Two exceptions are the Bank's support for the creation of semi-autonomous domestic tax and customs agencies in Jamaica, and its recent assistance in developing a new governance model for the tax agency (SAT) in Guatemala.







# 5 Design, Implementation, and Effectiveness

To assess the relevance of design, implementation, and effectiveness, OVE conducted case studies of seven countries that represent the extent and type of Bank engagement, as well as geographic and income diversity: Colombia, Guatemala, Honduras, Jamaica, Mexico, Paraguay, and Uruguay. Together these countries account for 54% of lending amounts and 37% of the number of loans with tax components approved in the period (Tables A.5.1 and A.5.2),<sup>32</sup> cover all Bank subregions, and capture LAC's heterogeneity in income levels and tax burdens (Table A.5.3). The types of interventions in these countries were also representative of the typical IDB support for TPA (Table 5.1).

OVE analyzed the seven country case studies using a comparative evaluation methodology to draw lessons about the Bank's support for TPA. In addition to reviewing the relevance, implementation, and effectiveness of each operation and country program individually, OVE compared various aspects of the projects and programs side by side to draw broader lessons. The country case studies (Annexes IV-X) provide a detailed analysis of Bank support at the country level, and this chapter summarizes the main comparative findings.

Given the nature of fiscal reforms, attribution of outcomes to Bank support is difficult, and thus this chapter highlights IDB's contributions to results. As noted in Chapter II, the design and implementation of tax reforms are conditioned by political economy factors and by the specific circumstances of each individual country. Complex negotiations among different stakeholders tend to shape the reforms supported by the IDB, and policy reversals are not only common but also difficult to anticipate and mitigate. OVE used multiple data sources to assess IDB's value-added, seeking to identify IDB's contributions to results rather than full attribution.

TABLE 5.1. THE BANK'S WORK IN COUNTRY CASE STUDIES, 2007-2016

	Tax policy	Revenue administration
CO	Since 2007, Colombia has undertaken several tax policy changes and two larger reforms. Through PBP, the Bank supported the implementation of the 2012 reform (which had been designed with World Bank support) and the design of the 2016 reform by financing a commission of experts. This reform was intended to raise tax revenues.	At the national level, the Bank's main support was through an investment loan to design and implement the electronic invoice system. At the subnational level, an investment loan for the Archipelago of San Andres and a conditional credit line for investment projects (CCLIP) (under which three operations have been approved so far, supporting nine municipalities) were intended—among other things—to enhance the fiscal capacity of local governments.
GU	With a PBL and TCs, since 2009 the Bank had provided technical and financial support to design a comprehensive tax reform, approved in 2012, to raise revenue by reforming the income tax, simplifying the VAT, and reducing tax expenditures, among other measures.	Early in the review period, the Bank supported institutional strengthening of the tax agency (SAT) with a PBP. In 2016, in coordination with other multilateral development banks, the Bank approved another PBL to support revamping the governance structure of the SAT.
HO	As part of a comprehensive program in TPA, the Bank supported the 2013 tax reform to increase tax revenue through a combination of higher tax rates and fewer tax expenditures.	In 2014, in partnership with the IMF, the Bank approved an investment loan to finance capacity building at the Executive Tax Direction (DEI); after long delays in implementation, it was eventually used to support the creation of an autonomous tax agency (SAR).
JA	Over most of the review period, the IDB worked jointly with the IMF. After an IMF program went off-track in 2010, there was a hiatus in IDB financial support (but not in TC and dialogue). Under a new IMF program, the IDB renewed its financial and technical support in 2013, which resulted in a long-awaited tax reform to reduce distortions and achieve fiscal sustainability.	In parallel to the support for tax policy reform, the Bank supported the modernization of the revenue and the customs administrations with an investment loan that began to disburse in 2012.
ME	Through two series of PBPs, in 2009 and 2014 the Bank supported reforms to reduce the country's dependence on oil revenue and raise tax revenues (by increasing rates, reducing exemptions, and simplifying taxes).	No investment loans were approved over the review period. PBP policy conditions supported the expansion of the use of electronic invoice to reduce evasion.
PR	After having supported a significant tax reform in 2003-04, the Bank approved two investment loans in 2008 that, among other things, were expected to advise on new tax codes.	The same two investment loans supported the institutional strengthening of the tax (SET) and customs (DNA) administrations. However, the program to strengthen the DNA was canceled because it was not endorsed by Congress.
UR	As part of a comprehensive TPA program, the Bank provided significant support for the 2006-07 tax reform, which introduced the dual income tax system and reduced the number of taxes.	In parallel, the Bank provided the financing for the modernization of the internal revenue agency (DGI) through a sector facility. A few years later, the Bank approved an investment loan to support the customs agency (DNA). At the subnational level, the Bank approved an investment loan and several TCs to help strengthen the fiscal capacity of departments.

Notes: <sup>a</sup> The equity objective was not explicit in the PBP (CO-L1142), but government counterparts noted that this program helped implement the 2012 reform, which did have equity components.



## A. TAX POLICY

### 1. Design

The IDB has developed substantial expertise in tax policy over the last decade and has increased its relevance as a “trusted advisor.” Despite some weaknesses, significant analytical and diagnostic work—carried out either by the Bank or, more often, by the IMF—underpinned most of the projects reviewed. Collaboration with the World Bank and the OECD, usually under the leadership of the IDB, also helped lay the groundwork for Bank interventions.<sup>33</sup> Clients and partners interviewed by OVE almost universally perceived the Bank as having strong technical expertise and a good reputation in fiscal matters (Box 5.1). Two aspects of this role are worth mentioning. First, IDB’s in-house expertise is more geared toward tax policy, with the Bank depending more on external consultants in the area of revenue administration. Second, IDB’s reputation on fiscal matters is highly dependent on key personnel and is therefore vulnerable to risks of staff turnover.

#### *Box 5.1. The IMF and the IDB: comparative advantages and the “trusted advisor” role<sup>a</sup>*

The IMF has a comparative advantage in fiscal analysis because of its established technical reputation and its large production of knowledge; however, it is not considered a trusted advisor in developing countries (Independent Evaluation Office 2013). That the IMF’s Fiscal Affairs Department has been the world’s leading source of fiscal expertise for over 50 years is reflected in the sheer size of the department: it has five divisions relevant to tax policy, revenue administration, and PFM, plus a research group, and roughly 250 specialists to follow about 180 countries.<sup>b</sup> However, there are several reasons why the IMF is not regarded as a trusted advisor, according to the IEO: (i) a perception that the IMF represents interests of developed economies (because of its shareholder structure); (ii) a tension between the Fund’s role of “watchdog” of the global economy and advisor at a bilateral level; in LAC, for example, it suffers from a historical stigma for having pushed painful reforms in times of crisis; (iii) countries rarely perceive that IMF advice is tailored to the country context; and (iv) IMF staff do not have incentives to build relationships with authorities, since they are mostly regarded for the programs they bring or research they produce (IEO 2013).

The IDB has some advantages compared to the IMF. IDB’s shareholding arrangement and regional knowledge help build a long-term relationship of trust with countries. In addition, the Bank has a variety of instruments that help support tax reform implementation (PBLs), finance expenditures in revenue administration (investment loans), and provide assistance on a continuous basis—through TCs and day-to-day dialogue between government authorities and Bank specialists in the field. This *acompañamiento* is especially important in low-capacity countries.

Despite these strengths, the Bank faces some risks and institutional disincentives. The IDB's in-house expertise is stronger in tax policy, and it relies primarily on external consultants in the area of revenue administration. Also, a trusted advisor relationship is highly personal and rooted in the reputation and stability of the Bank staff. Without a clear mechanism to ensure continuity in case of staff turnover (e.g., retirement), the Bank can easily lose its trusted advisor role. Moreover, staff spend disproportionate amounts of time on the disbursement-related activities that are demanded by the Bank's project cycle—time that they could be spending on the key tasks of trusted advisors (that is, frequent field visits, informal contacts, and participation in knowledge-related activities).

*Notes:* <sup>a</sup> In 2013, the IMF's Independent Evaluation Office explored that institution's role as a "trusted advisor." For more details on the definition of trusted advisor and the IMF's shortcomings in achieving that role, see IEO-IMF 2013.

<sup>b</sup> In comparison, the IDB has 25 fiscal specialists in FMM (10 in headquarters and 15 in the field) to cover 26 countries

In Central America and the Caribbean, the IDB and the IMF have developed an implicit partnership under which the two institutions complement each other. The IMF has a comparative advantage in fiscal analysis, and through its Fiscal Affairs Department it has provided substantial technical assistance to several of the IDB's borrowing member countries. However, the IMF lacks an investment lending instrument to support the implementation of its recommendations, especially in revenue administration. IDB instruments have been useful to help carry out many IMF recommendations, especially in Central America and the Caribbean. In addition, the Bank has led the technical analysis and the collaboration with authorities in several other countries including Colombia, Mexico, and Uruguay, with contributions from the IMF. Another advantage vis-à-vis the IMF is IDB's continuous presence in client countries.<sup>34</sup>

The Bank has usually supported tax reforms in moments of fiscal need, aiming at boosting tax revenue—a relevant objective for most countries in the sample. With few exceptions (e.g., Uruguay in 2006-2009), the Bank supported tax reforms carried out in the context of macroeconomic imbalances—precisely because, as the specialized literature shows, fiscal reforms are generally pursued in times of crises (see, for instance, Alesina, Ardagna, and Trebbi 2006). In four countries (Guatemala, Honduras, Mexico, and Paraguay) a main goal of reforms was to increase tax revenues. In most of those countries, tax revenues were below 14% of GDP at the beginning of the review period and total fiscal revenues were under 22% and volatile.<sup>35</sup>

Bank projects addressed non-revenue objectives directly or indirectly in four of the seven countries. In Jamaica, for example, the Bank helped design and implement policy changes to reduce the distortionary effects of tax expenditures, while in Mexico and Guatemala the Bank advised on how to design a more equitable and less distorting income tax. Uruguay's was the only reform expressly designed to be revenue-neutral and to enhance the equity of the tax system.<sup>36</sup> As a by-product of

some interventions in the other countries, though, the Bank tangentially addressed equity and efficiency issues (Table 5.2). For instance, in most countries Bank projects have worked toward the reduction of tax expenditures, which contributes to moderate the degree of distortion in the economy. Surprisingly, Bank projects did not tackle the issue of equity even indirectly in Paraguay, one of the LAC countries with more unequal income distribution.

In several reforms implemented in the context of pressing fiscal needs, policy changes aimed at bolstering short-term returns while overlooking their distortionary effects. For instance, in Honduras a 1.5% minimum tax on gross income was established (HO-L1030), and in Mexico, a PBL prepared during the international financial crisis halted the anticipated reduction of the CIT rates, delaying convergence with regional trends (ME-L1090).

TABLE 5.2. EQUITY AND ECONOMIC EFFICIENCY CONSIDERATIONS

Did Bank programs work toward increased...								
...Equity?					...Economic efficiency?			
Tax system (vis-a-vis LAC median)		Directly	Indirectly	No		Directly	Indirectly	No
	Relatively equitable	UR ME	JA		More efficient		UR CO HO	PR
	Relatively inequitable	GU	HO CO <sup>a</sup>	PR	Less efficient	JA GU <sup>b</sup> ME		

Notes: <sup>a</sup> In Colombia the Bank addressed equity issues tangentially, mostly through a PBP (CO-L1142) that supported the implementation of the 2012 reform. While the reform aimed at increasing equity through the creation of the CREE (see case study for details), disbursement conditions in taxation in the PBP related to aligning the tax code with the OECD.

<sup>b</sup> Guatemala's Economic Efficiency Index was above the LAC average in 2009-2009, but the country had tax expenditures well above the LAC average before the tax reform.

In some cases, project diagnoses could have been strengthened by a more comprehensive discussion of macro-fiscal and expenditure issues. Because tax policy cannot be isolated from overall fiscal policy, and particularly public spending, in some cases a more thorough analysis of the alternatives for closing fiscal gaps could have been useful. In this regard, the discussion of the expenditure side in many of the projects reviewed by OVE—including its composition and quality—was not sufficiently thorough. For example, the question of whether revenue increases would lead to higher public savings or be absorbed by current expenditures was not always considered (except in Jamaica). This limited focus on expenditure quality and composition may be the result of internal “silos” as the Bank concentrates TPA and PFM in FMM and sectorial public expenditure analysis in sector departments.

The depth of the reforms supported by tax policy operations tended to be greater than the Bank average. Roughly 34% of the conditions on taxation in the PBLs approved in the countries in the sample were of high depth, 41% of medium depth, and 25% of low depth, compared to 14%, 54% and 32%, respectively, for total Bank operations (Box A.5.1 and RE-485-6, based on 2005-2014 approvals).

Bank TCs were relevant in tax policy matters and were usually used to inform project design, help fulfill policy conditions in PBPs, or foster policy dialogue in specific areas. In Jamaica, for example, a TC (JA-T1066) conducted studies to diagnosis the main taxation issues and the development of a methodology to measure tax expenditures. As part of the work of a programmatic series, the Bank also helped develop a methodology to quantify subnational tax expenditures in Colombia (CO-T1283)—where TCs were also used to measure the impact of fiscal measures, such as the effect of the 2012 tax reform on informality (CO-T1345). Stand-alone TCs were relevant, too, and helped open dialogue in new policy areas. A case in point is Paraguay: in the context of the increasing royalties from Itaipú, a TC (PR-1103) supported fiscal management issues—although it was mostly focused on budget planning and execution.

OVE found weaknesses in the monitoring and evaluation frameworks of the projects reviewed. Results matrices relied heavily on the tax-to-GDP ratio indicator and, generally, lacked more specific and direct intermediate outcome indicators that could gauge the impact of many of the reforms. For instance, despite the emphasis on reducing tax expenditures, only a few projects included indicators on the revenue forgone because of exemptions and special treatments—presumably because of lack of data. Similarly, in PBLs that supported revenue administration, specific targets to measure effectiveness, such as amount of tax arrears or audit results, could have been included. At the subnational level, some projects included indicators that were too aggregate to capture the Bank's contribution—for example, Colombia's fiscal performance index. In terms of monitoring, the progress reports tended to punish projects that support institutional strengthening because they took longer to execute (see below).

## **2. Implementation and effectiveness**

PBPs with tax components and parallel TCs generally helped the Bank remain engaged in multiyear reform programs. Through three PBP series and several TCs, the Bank provided support to Jamaica's tax reform agenda for eight years, in spite of a hiatus in the middle.<sup>37</sup> The relatively low truncation rate of the PBP series in the sample supports the idea that the Bank usually remained engaged in long reform processes.<sup>38</sup> Indeed, the truncation rate in TPA PBPs in the sample is 27%, lower than the Bank average (32%, RE-485-6, based on PBPs approved between 2005-2014). This may support the idea that reforms call for a relational model of engagement.

Part of the Bank's value-added and effectiveness is attributable to informal technical assistance and ad hoc hiring of consultants. A main finding from OVE's field visits is that country counterparts perceive that the Bank has been effective in helping them solve (usually ad hoc) problems, irrespective of the operational portfolio. In particular, many interviewees mentioned that, when they were facing a specific

issue, the Bank provided high-quality and timely assistance, either through Bank specialists or, more often, through expert consultants. In such situations, the Bank has been flexible in adapting existing TCs or drawing on miscellaneous resources to respond to country needs (though at high transaction costs). For instance, in Paraguay several specific (and small) technical support visits and consultants were highly appreciated for their support in implementing the PIT and analyzing transfer price issues. Such efforts can easily pass unnoticed, as they are hard to measure and record, but they have played a crucial role in positioning the Bank as a trusted advisor in the fiscal field.

In countries with higher institutional capacity, the Bank had the dual role of providing technical advice and helping legitimize the measures, though its relevance was greater in lower-capacity countries. In Uruguay (2006-2007), Mexico (2014), and Colombia (2016), local authorities had a clear view of the direction of the policy measures that they wanted to implement. Yet the IDB led the policy dialogue with the authorities and helped consolidate the internal consensus for the reform, mainly because it was trusted and perceived as an “honest broker.” For instance, it helped set up commissions of experts in Uruguay and Colombia; it also intermediated between private and public-sector stakeholders in Jamaica. But it was in the poorest countries where the Bank had the largest value-added, taking a more hands-on role in the policy discussions, in the drafting of the legal instruments that implemented the reforms, and in the reform implementation process. In Honduras and Guatemala, for instance, the Bank moved step by step with the authorities in both tax policy and administration.

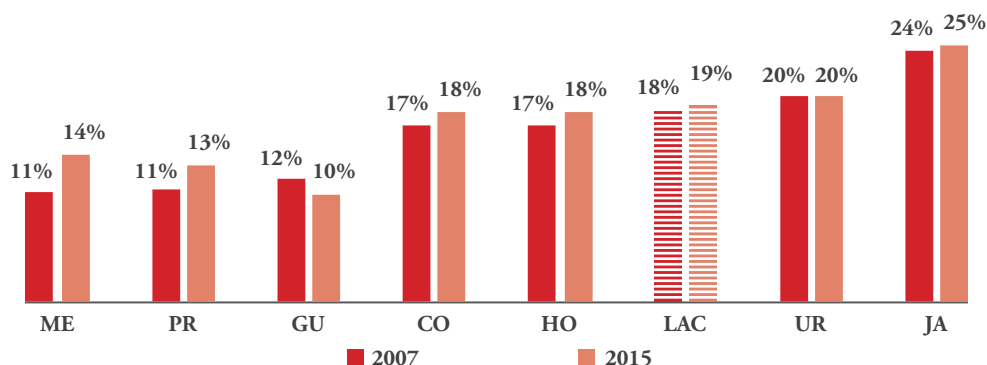
In terms of results, the work in Jamaica and Uruguay stands out as successful. With support from the Bank and IMF, Jamaica began taking policy measures in 2008, but it implemented more fundamental reforms in 2013-14. New legislation included a reform of investment incentives, a rationalization of tax exemptions, a reduction of the CIT rate and labor taxes, and adjustments to the PIT base and rates. Customs tariffs and GCT (VAT-equivalent) rates, and especially their dispersion, were also reduced. Although not all the results targeted in country strategies and individual operations were met, Bank support has contributed to some positive outcomes; for example, a reduction in tax exemptions and waivers led to increased tax collection and improved efficiency, as measured by OVE (Figures 5.1 and 5.2). As expected, some of the measures negatively affected the equity of the tax system—yet there was a policy shift toward greater use of public expenditure, rather than taxation, for redistribution purposes. In Uruguay, also in the context of an IMF program, the Bank supported the 2006-07 tax reform, which established the first dual tax system in LAC, rationalized the tax structure, and simplified SSC.<sup>39</sup> As a result, the share of direct taxes in total collection increased and the equity of the tax system (as measured by OVE’s indicator) improved substantially (Figure 5.3)—as expected, at the cost of lower efficiency. These two cases illustrate the trade-offs between equity and economic efficiency that tax reform can entail.



**FIGURE 5.1**

**Tax burden (% of GDP)  
in country case studies,  
2007 and 2015**

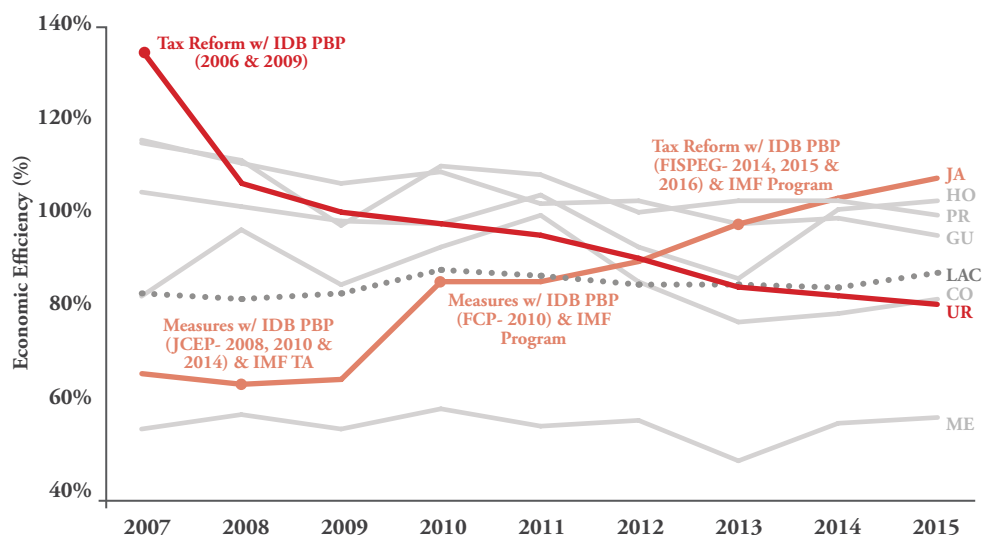
Source: OVE calculations based on Revenue Statistics in Latin America (OECD/ECLAC/CIAT/IDB 2017)



**FIGURE 5.2**

**Changes in the economic  
efficiency of tax systems**

Source: OVE calculations based on Revenue Statistics in Latin America (OECD/ECLAC/CIAT/IDB 2017).



In the other five countries, progress has been limited. In Guatemala, the Bank played a key role in the design of the 2012 fiscal reform, providing both the technical and financial support that led to the *Ley de Actualización Tributaria* and the *Ley Anti-Evasión II*. However, the implementation of the reform was limited by several factors, including the reversal of some measures, and as a result tax revenue did not increase. Similarly, in Honduras, the Bank supported reforms that included the tax code, but they were undone by the Government in spite of joint IDB-IMF efforts. In Paraguay, the authorities decided to reallocate funding from the tax component to finance the financial management system. In Colombia, the Bank-financed reforms aimed at raising tax collection at the national level, but little progress has been observed so far, and distortionary tax exemptions remain high. Mexico's tax reform improved the performance of the PIT, CIT, and VAT, which led to improved tax collection. In all cases except Guatemala, the tax burden has increased modestly throughout the period and remains below the regional average (Figure 5.1). However, so many factors affect this metric that it is hard to attribute progress to the Bank.

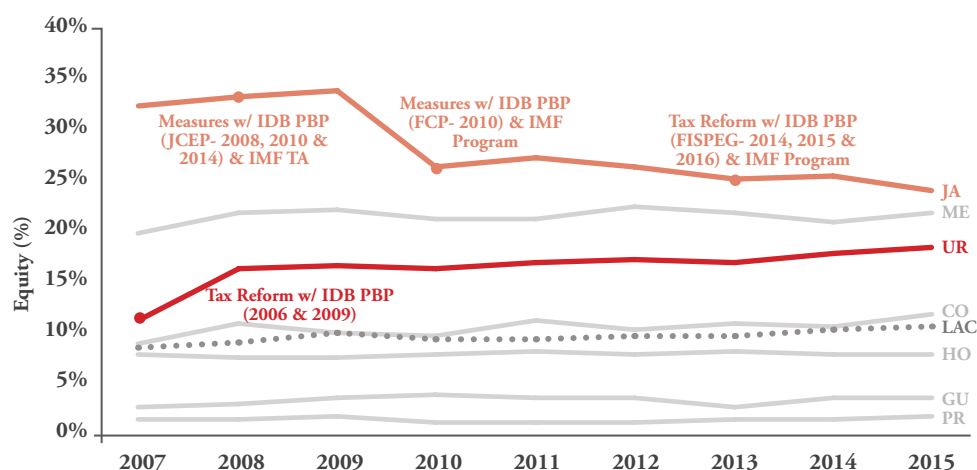


FIGURE 5.3

Changes in the equity of tax systems

Source: OVE calculations based on Revenue Statistics in Latin America (OECD/ECLAC/CIAT/IDB 2017)

## B. REVENUE ADMINISTRATION

### 1. Design

The objectives of Bank projects in revenue administration were relevant, considering the significant compliance gaps in the case study countries. The Bank supported revenue administration mainly through investment projects, with the aim of enhancing collection capacity—a suitable objective, given the large compliance gaps in most countries in the sample. This objective was generally pursued through changes in processes and information technology practices (Colombia, Jamaica, Paraguay, and Uruguay), the revamp of HR capabilities (Colombia, Guatemala, Honduras, Jamaica, Paraguay, and Uruguay), and organizational reforms (Honduras, Jamaica, and Uruguay). In several of these countries, the IDB was supported by the expertise of the Inter-American Center of Tax Administration (CIAT). Moreover, the Bank gave greater support through investment loans to the weakest tax collection agencies: relative to the annual administrative costs of the collection agencies, the “annualized” original amounts approved represented 20% in Honduras (2008) and 13.8% in Paraguay (2008) compared to 4.8% in Uruguay (2007) and 0.8% in Colombia (2012).<sup>40</sup>

In some countries, though, the relevance of design was more modest because long-lasting governance problems received little attention. Technical and institutional reforms like those supported in Honduras and Guatemala over most of the review period were, by design, unlikely to have a significant impact because they gave limited attention to governance issues—arguably the main binding constraint to improving tax collection capacity in those countries. More recently, the Bank started to address these issues, supporting the creation of a new agency in Honduras in 2016 and the reform of Guatemala’s SAT in 2015.

Despite the importance of the complementarity between tax policy and revenue administration, IDB projects did not exploit its full potential. Only in Honduras, Jamaica, and Uruguay did the Bank put in place a “tax program” addressing the



The Bank supported tax reforms carried out in the context of macroeconomic imbalances—precisely because, as the specialized literature shows, fiscal reforms are generally pursued in times of crises.  
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three key pillars of tax reform: changes to the tax base, changes to the tax rates, and measures to enhance the effectiveness of administration agencies. In these countries, the Bank provided both funding and technical assistance for reform design and implementation through PBLs, investment loans, and TCs. In Guatemala, the Bank attempted to support both policy and administration changes, but most of these efforts were undermined by a corruption scandal at the SAT and opposition from stakeholders. In the other three countries, the connection between tax policy and administration was weaker.

The relevance of including revenue administration conditions in PBLs with no associated TCs or investment loans is questionable, especially in countries with lower income and capacity. All the countries except Paraguay used PBLs, many of which contained conditions related to revenue administration (in addition to tax policy issues). However, as mentioned earlier, only in Honduras, Jamaica, and Uruguay were PBLs complemented with investment loans aimed at improving the revenue administration. OVE's interviews revealed that the usefulness of including conditions to encourage changes in the collection agencies is usually limited, especially in countries with weak revenue administrations, for two reasons. First, revenue administration reforms are hardly stroke-of-the-pen reforms, but rather

require significant sustained support (*acompañamiento*) and specific diagnoses and investments.<sup>41</sup> Second, PBLs are directed toward the Ministry of Finance and not to the tax agency, which is ultimately responsible for reform implementation.

Not least because of internal Bank “silos,” projects that had objectives on increasing revenues internally and at customs were not entirely integrated. The limited coordination within the Bank (particularly between INT and FMM) led to technical weaknesses in the design of loans. A case in point is the project to finance the electronic invoice system in Colombia (CO-L1138). The project was initially led by INT with the objective of facilitating trade, overlooking the implications of the electronic invoice for tax evasion and underestimating the challenges associated with its adoption. Similarly, some of the design weaknesses in a customs modernization project in Uruguay (UR-L1037) could have been avoided if the experience of a previous loan that had financed the modernization of the internal revenue administration (UR-L1026) had been considered. Finally, there was evidence of limited coordination in the design of Paraguay’s internal revenue and customs projects (PROFOMAF II and PR-L1026) and in Jamaica’s fiscal administration modernization program (JA-L1039). The few double-booked operations between these divisions might be an indication of coordination problems (Box A.5.2).

The Bank exhibited great capacity for learning and innovation, particularly in its approach to subnational governments. In Uruguay (UR-O1048) and Colombia (CO-X1018) the Bank was a pioneer in engaging with subnational governments. Following the Mexican experience in the late 1990s, the Bank based its strategy on incentives: in exchange for politically difficult measures—such as improving the cadaster to better enforce property taxes—subnational governments received resources to finance visible infrastructure projects (water and sanitation, waste management, etc.). In Uruguay, following more than three decades of work at the subnational level, the Bank adapted the design of projects to nudge local authorities to improve fiscal management. In Colombia, the link between components is subtler and the portion for the institutional strengthening components is too small to expect large changes (Table 5.2).

The Bank used TCs to address key revenue administration issues, mostly at the subnational level. At the national level, only a few TCs with revenue administration components were approved; their support ranged from financing public campaigns to promote electronic invoicing (CO-T1293) to “horizontal cooperation” trips between countries to share experiences in tax administration (PR-T1111). At the subnational level, TCs generally aimed at addressing key—usually long-standing—weaknesses. Examples include a TC to support the City of Guatemala in its efforts to enhance tax and fiscal institutions (GU-T1226); two PRODEV TCs in Mexico with some tax components in the states of Michoacán (ME-T1139) and Baja California (ME-T1138); and two TCs in Uruguay to support the updating of subnational cadasters (UR-T1103 and UR-T1135).

## 2. Implementation and effectiveness

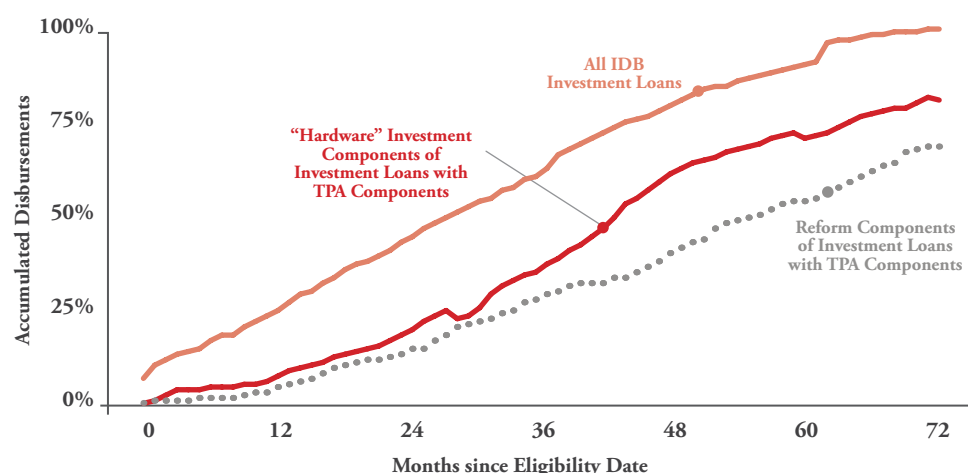
The implementation of investment loans was marred by delays, which in some cases led to design obsolescence. Even relative to Bank investment loans in general, the execution of those with tax components is typically slower—especially the components that support reforms of tax collection agencies (Figure 5.4). As a result, extensions are longer.<sup>42</sup> Weak coordination between Bank divisions and design flaws partly explain these delays (the loan that supports the expansion of the electronic invoice system in Colombia (CO-L1138) is a case in point). However, most frequently the delays resulted from procurement processes (these loans make extensive use of consultants and firms), changes in “reform champions,” and internal resistance to reform. The loan to support the Executive Tax Direction (DEI) in Honduras (HO-L1015) illustrates the first two issues,<sup>43</sup> while the loans for the modernization of the General Taxes Directorate (DGI) and the Customs Administration (DNA) in Uruguay (UR-L1028 and UR-L1037) illustrate the third. Although the original design of some of these projects became obsolete, the Bank has been flexible to adapt loans to countries’ changing needs. However, OVE did not identify any strategic behavior of funds being redirected from reform components to easier-to-execute “hardware” components (e.g., buildings, equipment).<sup>44</sup>

In terms of results, substantial progress in the revenue administration offices of Jamaica and Uruguay led to large reductions in VAT noncompliance (Figure 5.5). In Jamaica, implementation delays notwithstanding, the Bank’s investment operation (JA-L1039) has funded key investments to strengthen tax (and customs) administration. There are signs that these investments have contributed to progress in tax administration, including an important reduction in noncompliance with the general consumption tax (the VAT equivalent), an increase in audits for large and medium taxpayers, and expansion of e-filing and e-payment. These advances were reflected in the World Bank’s Doing Business reports, which indicate that the overall ease of paying taxes has improved quickly. In Uruguay, with IDB support, the DGI was restructured and adapted to the requirements of the new tax legislation passed in 2006. As a result, the DGI experienced meaningful improvements in terms of human resources, information technology, and organizational structure and functioning. These changes translated into higher control and audit capabilities, which ultimately led to higher compliance. The IDB also contributed to the restructuring and institutional strengthening of the DNA, which improved control and audit and, consequently, tax collection at customs.

All the other countries show varying degrees of progress (Table 5.3), and some show that other well-functioning institutions (such as the judiciary system) are needed to increase institutional capacity. In Honduras, the deterioration of the tax agencies prevented the achievement of significant results, despite continued relevant IDB work. In Paraguay, the loan restructuring meant that less than half the expected resources were used for the modernization of the SET, and the main activities

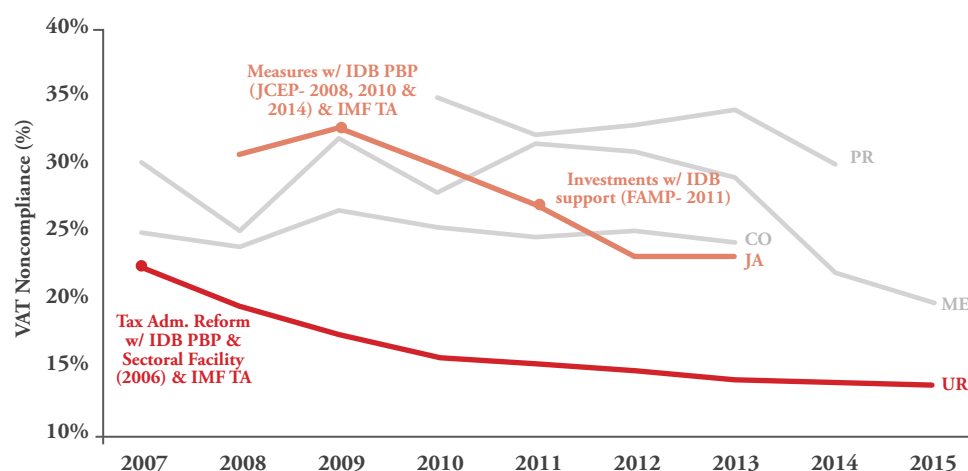


financed were training of and communication with personnel. Though the SET achieved some reduction in VAT noncompliance, this can hardly be attributed to IDB's operations. In Colombia, loans are either too recent for results to be observed (e.g., subnational level CCLIPs), or execution has suffered substantial delays (CO-L1138). In Guatemala, the institutional deterioration of the SAT culminated in a corruption scandal. Despite some measures aimed at boosting efficiency and transparency in tax revenue (GU-L1008), IDB disengaged during most of the period and only recently reengaged, with a loan to support the new governance of the institution. Without a counterfactual, it is unclear whether the deterioration of the SAT would have been less severe if the IDB had remained engaged, or what might have been the reputational costs of such engagement.



**FIGURE 5.4**  
Disbursement of  
investment loans,  
2007-2016

Source: OVE, based on IDB Data Warehouse.



**FIGURE 5.5**  
VAT noncompliance,  
2007-2015

Source: OVE, based on government data.

In sum, four aspects of the Jamaica and Uruguay programs seem to have contributed to IDB's effectiveness. First, swiftly seizing the windows of opportunity and working with organizations that assumed the role of "reform champions" served to advance the reforms. In contrast, in Honduras and Guatemala lack of government ownership

or actual opposition affected the results adversely. Second, reforms have generally been more effective when tax policy and revenue administration were addressed together under a comprehensive and internally consistent reform program. Third, in both countries the Bank and the IMF established implicit partnerships, aligning policy conditions in Bank PBPs with recommendations from IMF technical reports. Coordination was even greater in the context of an IMF Stand-by Arrangement or EFF—which likely reflects that multilaterals have higher leverage in moments of high fiscal needs. Finally, long-term sustained engagement—including policy dialogue and TCs—proved key.

TABLE 5.3. REVENUE ADMINISTRATION: SELECTED INDICATORS

	Indicator	Baseline (year)	Expected result (year)	Observed result (year)
GU	VAT noncompliance	34.2% (2015)	25% (2018)	34.2% (2015)
	Online system to report PIT and VAT implemented	-	-	In place
JA	Number of LT audits	8 (2012/13)	156 (2016/17)	100 (2015/16)
	Number of MT audits	100 (2012/13)	200 (2016/17)	122 (2015/16)
	Large taxpayers e-filing/total large taxpayers - CIT (%)	55 (2012/13)	85 (2016/17)	95 (2015/16)
	Large taxpayers e-filing/total large taxpayers – general consumption tax (%)	24 (2012/13)	95 (2016/17)	97 (2015/16)
PR	VAT noncompliance (%)	30 <sup>a</sup> (2015)	25 (2018)	N/A
	Operative cost of the internal tax administration, as compared to collected internal taxes (%)	1.3 (2007)	1.3 (2007)	1.3 (2010)
	Active registered taxpayers	429,453 (2007)	558,300 (2017)	437,445 (2016)
UR	DGI's tax collection efficiency index	110,6 (2005)	114,3 (2008)	120 (2008)
	VAT noncompliance (%)	23 (2007)	-	13 (2014)
	CIT noncompliance (%)	70 (2007)	-	40 (2014)

*Note:* Further details are provided in the Country Case Studies Annexes.

<sup>a</sup>Loan documents state 34.4%, but updated data show that the figure was closer to 30% in 2015.

### 3. Sustainability

In some cases, the Bank seized a political window of opportunity to support more structural, long-lasting reforms. In Jamaica, Mexico, and Uruguay, the governments secured a nationwide agreement involving the different stakeholders—including the private sector and the opposition parties—and the IDB and the IMF provided the seal of approval that helped legitimize the reforms. In Colombia, the reform process advanced more slowly and no large reversals were experienced.

Sustainability challenges seem to be compounded in poorer countries, with their lower levels of institutional development and pressing fiscal needs. Windows of opportunity for reforms were relatively narrow, and reforms were associated with short-term fiscal needs within a pattern of recurrent, partial reforms. Honduras is an extreme example, where permanent tax reforms and changes in the tax collection agency are frequently correlated with the political cycles and driven by short-term fiscal needs. Such tax reforms are soon neutralized, and the tax agency experiences systematic waves of improvement and deterioration. Moreover, in Honduras, the suboptimal nature of some of the measures adopted (e.g., 1.5% gross revenue advance tax) ultimately militated against the sustainability of such important reforms as revamping the customs administration and establishing a new tax code. To a lesser extent, Guatemala also experienced a reversal of some of the achievements. Soon after the *Ley de Actualización Tributaria* was passed in 2012, several modifications were approved, including the granting of tax benefits and deductions, the reversal of the increase in the tax on the circulation of vehicles, and the replacement of the National Customs Law by a more lenient one.



Clients highly value IDB's know-how, drawn from experience with reform implementation in other countries in the region, and there seems to be room for the Bank to foster further horizontal cooperation and to better use TC-INTRA.

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# 6 Conclusions and Recommendations

**OVE finds that TPA projects were particularly relevant in countries with low tax revenues. The Bank has usually combined tax work with PFM and macro-fiscal analysis. The objective of the tax components has been relevant, particularly as the Bank has focused on countries with lower revenue capacity and has supported countries in times of macroeconomic distress. The emphasis on raising revenue by strengthening the capacity of collection agencies and broadening tax bases has been consistent with country priorities and best practices. At the subnational level, the Bank has worked to enhance revenue capacity, usually as part of a strategy to boost property tax receipts and decrease reliance on transfers (especially in South America).**

Explicit consideration of the trade-offs between revenue and other policy goals has been less frequent, though implicit recognition of these trade-offs was more common. Several projects were apparently expected to improve the equity of the tax system as a by-product of reforms to the income and property taxes. Similarly, projects were arguably expected to reduce distortions in the economy by helping countries measure and moderate tax expenditures. Several Bank knowledge products did explicitly analyze the trade-offs between enhancing equity and economic efficiency. Because tax policy is part of overall fiscal policy, a more thorough analysis of the alternatives for closing fiscal gaps would also have been useful in some cases.

In some cases, project diagnoses could have been strengthened by a more comprehensive discussion of governance issues. Relevance of design was sometimes modest because governance problems remained mostly unaddressed.



The use of instruments was adequate, but there is room to enhance complementarity between tax policy and revenue administration projects. Most revenue administration projects were undertaken with investment loans, although tax administration measures were also supported by PBLs. The relevance of supporting revenue administration measures exclusively through PBLs (with no parallel TCs or investment loans) is questionable, especially in countries with lower income and capacity. Of the seven country case studies, only in Honduras, Jamaica, and Uruguay did the Bank put in place a “tax program,” assisting in tax policy and administration issues through a combination of lending and nonlending instruments. The implementation of investment loans was affected by delays (above Bank average), risking the loss of government ownership. Yet, when priorities changed, the Bank was flexible in accommodating loans to countries’ changing needs. Clients highly value IDB’s know-how, drawn from experience with reform implementation in other countries in the region, and there seems to be room for the Bank to foster further horizontal cooperation and to better use TC-INTRA.

Part of the Bank’s value-added and effectiveness is attributable to informal technical assistance and ad hoc hiring of consultants. Country counterparts perceive that the Bank has been effective in helping them solve problems, irrespective of the operational portfolio. This includes sharing the Bank’s experience and lessons on reform implementation drawn from other countries in the region. Such efforts can easily pass unnoticed as they are hard to measure and record. This type of assistance is usually financed in an ad hoc manner, typically with the resources of existing TCs, and at high transaction costs. In terms of expected results, and considering both tax policy and administration, Uruguay and Jamaica experienced the greatest progress. Results in the other five countries have been more limited.

This informal engagement with clients, coupled with greater in-house expertise (more in tax policy than in revenue administration) has helped the Bank to be seen as a trusted advisor in tax issues in LAC. Since the IDB’s Realignment in 2006, the Bank has increased its strategic and operational emphasis on taxation. There is consensus that the Bank has enhanced the soundness of its technical work and has strengthened its reputation in fiscal matters—which might explain the successful partnership with the IMF in several countries in Central America and the Caribbean. In addition, the Bank has been successful in engaging in informal and long-term relationships with most countries.

Based on the evaluation findings, OVE has four specific recommendations and a more general one:

- Continue to work towards understanding and addressing trade-offs in fiscal reforms. Since LAC continues to be the most unequal region in the world, the Bank’s knowledge products and policy dialogue in the fiscal area should systematically strive to address equity as well as efficiency and revenue needs,

whether through tax or expenditure policies. Moreover, whenever possible, Bank projects should recognize the implications on equity and efficiency of the supported tax reforms.

- Support the trusted advisor role by ensuring sufficient and sustainable in-house expertise in both tax policy and revenue administration. This may entail strengthening in-house know-how on revenue administration, while continuing to use specialized consultants to provide specific expertise as needed. Since the trusted advisor role is sensitive to staffing in the organization, the Bank will need to have training and transition arrangements in place to ensure that the role is sustainable even with staff turnover.
- Foster greater cooperation among tax authorities in LAC. The Bank should play a key role in engaging the more advanced countries in the region (as well as the higher-capacity states and municipalities) to share knowledge with revenue administrations in less developed locations. In this effort, further use of TC-INTRA is recommended. The partnership with the Inter-American Center for Tax Administration should also be strengthened to facilitate the sharing of best practices.
- Continue to seek synergies between the Bank's support for tax policy and revenue administration. Strengthening a tax system typically requires policy reforms as well as changes in implementing institutions. Though simultaneous Bank support to both may not be feasible or requested by the authorities in every country context, the Bank should continue to look for opportunities to provide synchronized support through an appropriate mix of PBLs, investment loans, and reimbursable and/or non-reimbursable TCs as needed.
- Adapt Bank processes and procedures to facilitate longer-term and continuous support to clients. The trusted advisor role and the *acompañamiento*—two of the identified sources of IDB value-added in TPA—require that Bank staff devote time to knowledge generation activities, keep engaged in policy dialogue, and continue supporting the reform process even after the end of an IDB operation. To this end, the Bank should explore new or expanded uses of instruments to facilitate longer-term and continuous engagement, such as reimbursable programs of technical assistance with less specific up-front identification of expected results. The Bank should also revisit staff incentives to better recognize and reward the trusted advisor role.



- <sup>1</sup> Such as the Economic Commission for Latin America and the Caribbean (ECLAC) and the Organization of American States and its specialized organizations (e.g., the Inter-American Center for Tax Studies and the Inter-American Center for Tax Administration (CIAT).
- <sup>2</sup> Sector lending (later renamed PBLs) was first introduced under IDB-7 in 1989 on a limited basis and for general reform purposes. IDB-8 (1994, AB-1704, para. 2.52) calls for more emphasis on public sector reforms, including tax reforms: “Policy lending during the Eighth Replenishment will continue to support economic adjustment programs [...], but greater emphasis will be on reforms in the public sector (i.e., in tax, budget and expenditure policies, institutional strengthening and support for sub-national governments).” In that context, the Bank emphasized the importance of increasing tax revenue by improving tax and customs administrations, as well as the need to strengthen tax neutrality and make systems more equitable by broadening the tax base (IDB 1994, p. 28).
- <sup>3</sup> Annex III provides a detailed institutional history of fiscal issues at the IDB.
- <sup>4</sup> As explained in Annex III, an exception is the creation of a Fiscal Unit (INT/FIS) in 1994. FIS, in coordination with the three Regional Operations Departments, was expected to oversee the preparation of all fiscal projects. However, Country Divisions prepared most investment loans and TCs and FIS led no PBLs, providing support solely as part of project teams (OVE, 2008).
- <sup>5</sup> This study covers the full range of taxes—the VAT, PIT, CIT, property taxes, excises, and customs duties, and “others”—a category that includes taxes on financial transactions, taxes on specific services, and payroll taxes (excluding contributions that confer entitlement to social benefits, such as SSC, contributions to unemployment insurance, disability, etc., as per OECD/ECLAC/CIAT/IDB 2017).
- <sup>6</sup> For example, in the late 19th century a significant share of the African-American and Native American populations abstained from voting in many states in the United States because of the “poll tax,” a tax that applied only to male voters whose grandfathers had not voted before the abolition of slavery.
- <sup>7</sup> A classic example is 17th-century England’s “window tax” based on the number of windows in a house. Because of the tax, people started to block up the windows, new houses were built with fewer windows, and the production of glass stalled; in the end, the tax failed to yield the expected revenue.
- <sup>8</sup> Tax expenditures are defined as the revenue forgone by the State when it grants incentives or benefits that reduce the tax burden for certain taxpayers.
- <sup>9</sup> For consistency, this section focuses on the indicators available for IDB member countries since 1990. The main data source is the OECD’s “Revenue Statistics in Latin America and the Caribbean, 2017”—available for all IDB borrowing member countries but Guyana, Suriname, and Haiti. Additional data come from IMF’s Government Financial Statistics 2016 and the joint IDB-CIAT database on “Equivalent Fiscal Pressure in Latin America 1990-2015.” Box A.3.1 summarizes the main concepts used in the evaluation.
- <sup>10</sup> Venezuela’s SENIAT integrates tax and customs administrations but is not an autonomous agency.
- <sup>11</sup> For a summary of tax reforms in LAC between 2010 and 2015, see Arenas de Mesa (2016).
- <sup>12</sup> The CIT is especially important in the tax structure of commodity-rich countries.
- <sup>13</sup> Including SSCs, the share of taxes on total revenue increased from 64% in 1996 to 81.4% in 2015.
- <sup>14</sup> Some countries with low tax burdens, such as Mexico and Trinidad and Tobago, have high fiscal burdens because of royalties, contributions, and other forms of non-tax revenues.
- <sup>15</sup> Recent research suggests that a tax-to-GDP ratio above 12.75% (excluding SSC) is necessary to achieve sustainable increases in real GDP per capita (IMF WP 16/234).
- <sup>16</sup> In the last two decades, Latin America has seen a strong trend toward decentralization. Argentina and Brazil (federal countries) have achieved the highest levels of subnational fiscal decentralization, as measured in terms of both expenditures and revenues, followed by Colombia and Bolivia (unitary countries) (Gomez-Sabaini and Moran 2013).

- <sup>17</sup> Not only are royalties a significant share of local government budgets in some of the resource dependent countries in the region, but their distribution is often biased toward the revenue-producing regions, causing imbalances. For instance, in Peru, 20% of royalties are distributed to producing regions and 30% to local governments (see Vinuela, Kaiser, and Chowdhurie-Aziz 2014).
- <sup>18</sup> Note, however, that the regressive effects of indirect taxes can be reduced if the yield is used to finance higher spending in growth- or equity-enhancing areas (education, infrastructure, etc.). Also, in LAC the regressive effect of the VAT is partly moderated by the fact that important components of the consumption of the poor are exempt from the VAT or taxed at low rates (IDB 2013).
- <sup>19</sup> For example, Martorano (2014) reports that the 2006-07 tax reform in Uruguay generated a positive impact on equity, and similar claims are made concerning the 2014 tax reform in Chile (IMF 2015; World Bank 2015). In addition, Cruces and Gasparini (2008) point out that the redistributive capacity of the Argentinian tax system has increased since the early 2000s, while tax systems in the Andean and Central American countries still show only a modest capacity to redistribute. Cano (2015) reports that personal income taxation is highly progressive in Ecuador but its ability to redistribute is low because rich people still benefit from many legal tax deductions. Despite progress, the redistributive incidence of taxation in Nicaragua is small (Cornia 2011). Finally, the tax system in Bolivia and Honduras is regressive because of the high reliance on indirect taxes and the small contribution of direct taxes (Cornia 2011; ECLAC and IEF 2014).
- <sup>20</sup> Uruguay abolished the financial transaction tax (FTT) and the border adjustment tax (BAT) in 2007; Ecuador did the same in 2008; Brazil eliminated the FTT in 2008, and Mexico abolished the BAT in the 2011-2013 reform.
- <sup>21</sup> These were Argentina, Brazil, Colombia, Costa Rica, Ecuador, Mexico, Uruguay, and most Central American countries—still on a pilot, voluntary basis. In 2014 Mexico became the first country to completely abolish paper invoices.
- <sup>22</sup> As Annex III explains, a partial exception is the creation of a Fiscal Unit (INT/FIS) in 1994. The Fiscal Unit, in coordination with the three Regional Operations Departments, was expected to oversee the preparation of all fiscal affairs projects. However, Country Divisions prepared most investment loans and TCs and FIS led no PBLs, providing support solely as part of project teams (OVE 2008).
- <sup>23</sup> Most of the loans that cover tax issues also include PFM and macro-fiscal issues; additionally, PBLs do not specify the share of the amount approved that is allocated to each issue (or component). As a result, OVE was unable to identify the amount approved to support TPA exclusively.
- <sup>24</sup> Except in Jamaica, the number of loans follows a similar distribution. This can be explained by the IDB's coordination with IMF-supported programs since 2009 (Annex VII).
- <sup>25</sup> On average, almost 60% of TPA loans in 2012-2016 involved work with subnational governments, as compared to half between 2007 and 2011.
- <sup>26</sup> This should be interpreted as the lower bound of all knowledge products, as BRIK covers only a subset of all knowledge products of the Bank. These products include several types of publications (ranging from books to policy notes and monographs), databases, blogs, impact evaluations, and seminars.
- <sup>27</sup> There are, of course, exceptions. At the policy level, the Bank supported comprehensive tax reforms in Uruguay (2005-06), Guatemala (2008-12), and Jamaica (2010-14). At the administration level, the Bank supported the revamping of collection agencies in Uruguay (2006-07), Dominican Republic (2007-2009), Jamaica (2011-16), Honduras (2013-15), and Guatemala (2016).
- <sup>28</sup> Specifically, IDB-9 called for increasing the ratio of actual to potential tax revenues.
- <sup>29</sup> In terms of efficiency, only 11% of the loans were expected to reduce the distortionary features of the tax system. In terms of equity, only 15% of the loans stated that the support provided was expected to affect income distribution, equity, or the progressivity of the tax system, and an even smaller proportion included specific indicators in the results matrix.



- <sup>30</sup> See Barreix, A., Roca, J. and Vilella, L. (2007); Barreix, A., Bes, M. and Roca, J. (2009); and Barreix, A., Roca, J. and Vilella, L. (2010).
- <sup>31</sup> See Mexico Case Study. Note that this office, called CITA, was never created.
- <sup>32</sup> The 37 loans approved with tax components in these seven countries totaled US\$6.1 billion. Moreover, these countries account for 56% of TC amounts and 44% of the number of TCs with tax components approved since 2007. Brazil—the country with by far the largest number of interventions with tax components—was excluded, as was explained in the introduction.
- <sup>33</sup> The Bank has also worked jointly with other multilateral and bilateral agencies for international cooperation, including the European Union, Germany (GIZ), Spain (AECI), Switzerland (SECO) and China.
- <sup>34</sup> However, the IMF provides substantial assistance through its regional centers.
- <sup>35</sup> As was mentioned in Chapter III, countries with tax revenues that are not comfortably above 13–15% of GDP are unlikely to experience sustained real GDP growth over the long run.
- <sup>36</sup> Colombia is somehow different. Between 2007 and 2016, the country implemented seven tax reforms, some of them to increase revenues and others to improve efficiency and equity. However, the Bank mostly supported the 2016 reform, which was aimed at raising tax revenues.
- <sup>37</sup> Jamaica Competitiveness Enhancement Program, three loans planned and delivered; the Fiscal Consolidation Program, three loans planned, two delivered; and the Fiscal Structural Program for Economic Growth, three loans planned and delivered. To a lesser extent, the Bank consistently supported the tax policy reform in Guatemala (starting with the diagnosis in 2006 all the way to 2013) and Honduras (since 2014).
- <sup>38</sup> Between 2007 and 2016, there were 14 policy-based loans with tax components active in the countries in the sample—3 PBLs and 11 PBP series. Of the PBP series, eight have been completed or are still on track to be completed. The three truncated PBPs are “Modernizing the Tax System and Enhancing the Quality of Public Expenditure” in Uruguay, the “Program to Support the Consolidation of Fiscal Sustainability” in Mexico, and the “Fiscal Consolidation Program” in Jamaica.
- <sup>39</sup> The semi-dual tax system in Uruguay was implemented almost concomitantly in Spain and Slovenia, and was followed by Germany and Peru (2008) and, some years later, by several Central American countries (El Salvador, Guatemala, Honduras, Nicaragua, and Panamá).
- <sup>40</sup> This assumes a five-year project life.
- <sup>41</sup> Arguably, PBLs could serve to enhance the legal framework of collection agencies; however, in most cases, the policy conditions in the PBLs in the sample addressed processes and measures, such as the implementation of electronic invoicing for large taxpayers in Honduras (Box A.5.1).
- <sup>42</sup> On average, the difference between the current and the original expiration date of the investment loans with tax components approved over the evaluation period in the sample is 427 days, compared with 291 Bankwide.
- <sup>43</sup> In terms of procurement, the loan had 196 contracts of a median value of about US\$20,000 each (compared to a Bankwide average of 60 contracts per loan). In terms of changes in local ownership, the loan suffered from high turnover of the head of the DEI, which led to an institutional crisis in 2012 and the replacement of the DEI with an entirely new tax agency in 2015. The loan only started disbursing significantly in 2012—more than four years after its approval—and resources were mostly used to support the transition to the new tax agency.
- <sup>44</sup> OVE looked at all the investment loans in the portfolio and analyzed all 34 operations for which detailed component-level financial information was available. This information was matched with procurement plans to reconstruct the amounts approved for reform components and for goods and infrastructure (G&I). The main finding is that the shares of investment loans financing reforms and G&I are roughly similar (46% and 47%, respectively). Moreover, the changes over time show no definite pattern. More specifically, there is no trend to reduce reform components in favor of G&I components. Instead, the changes between original amounts approved and executed budgets are as good as random.



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