Taxation and Equality in Latin America

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Fiscal Policy and Equality in Latin America

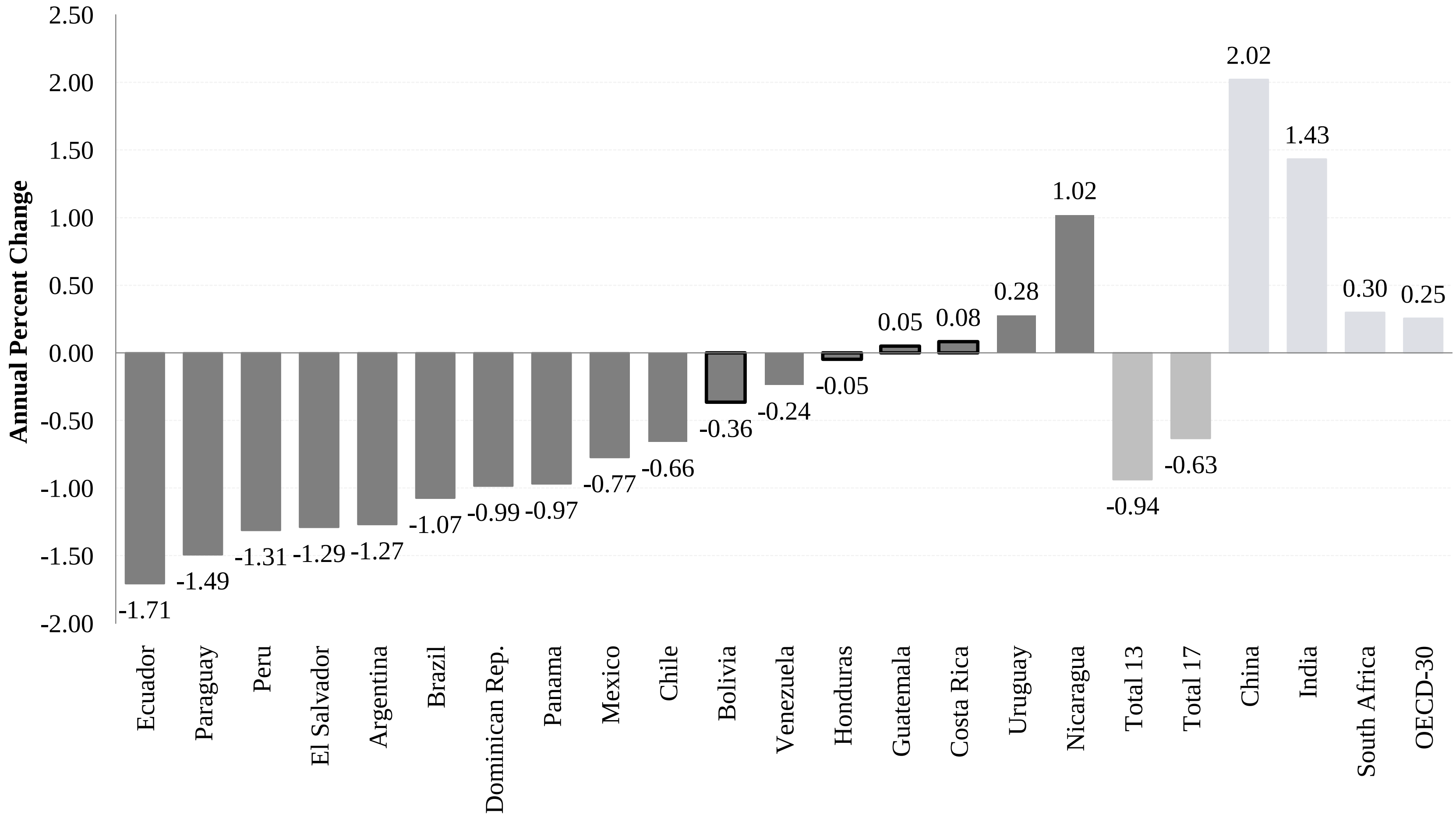
- Since 2000, inequality in Latin America has been declining; cash transfers to the poor have played a nontrivial role

However,

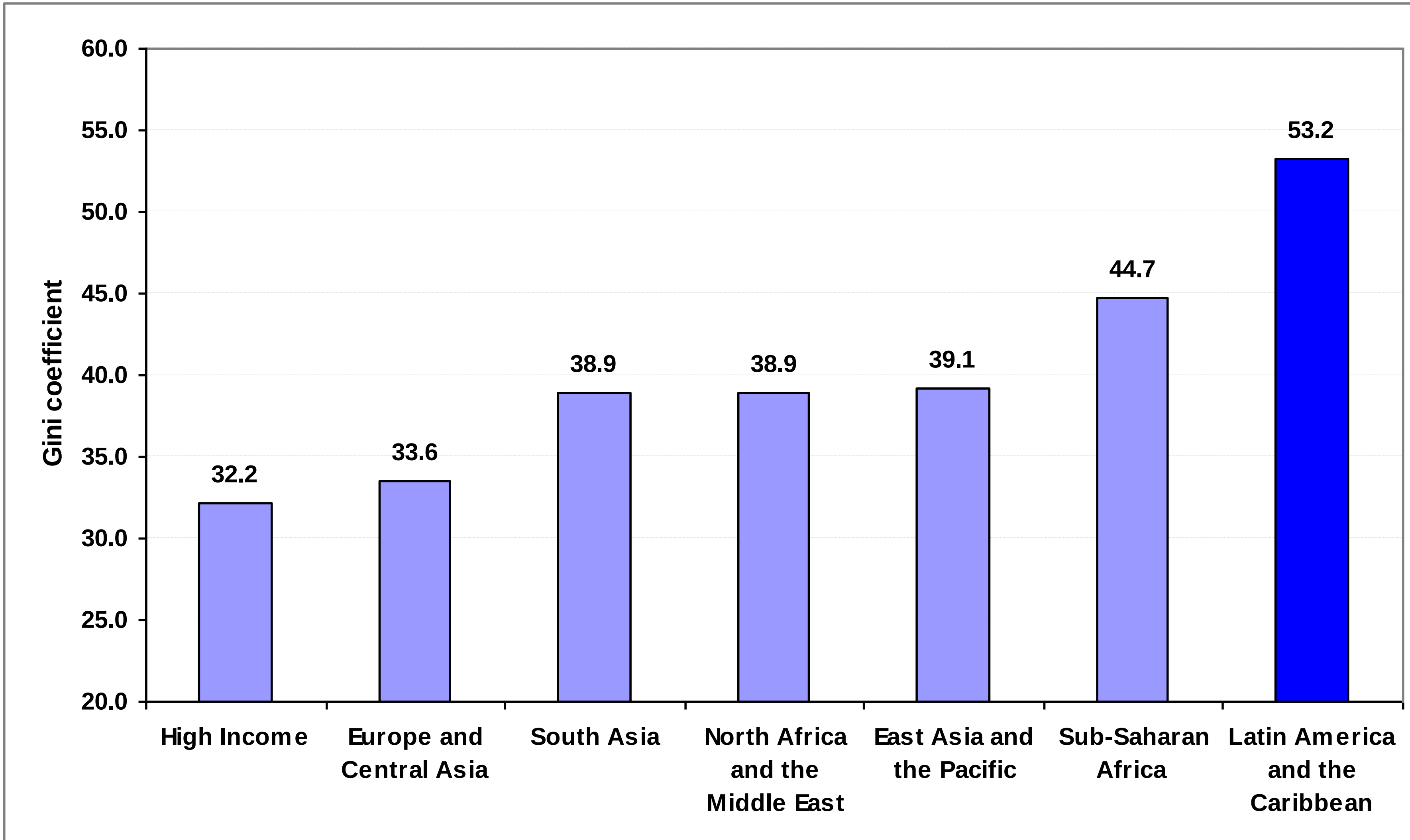
- Latin America is still the most unequal region and redistributes little
- Commitment to Equity Assessment (CEQ) project evaluates fiscal policies;
  - Diagnostic framework
  - Index of Commitment to Equity

Inequality has been declining: 2000-2009

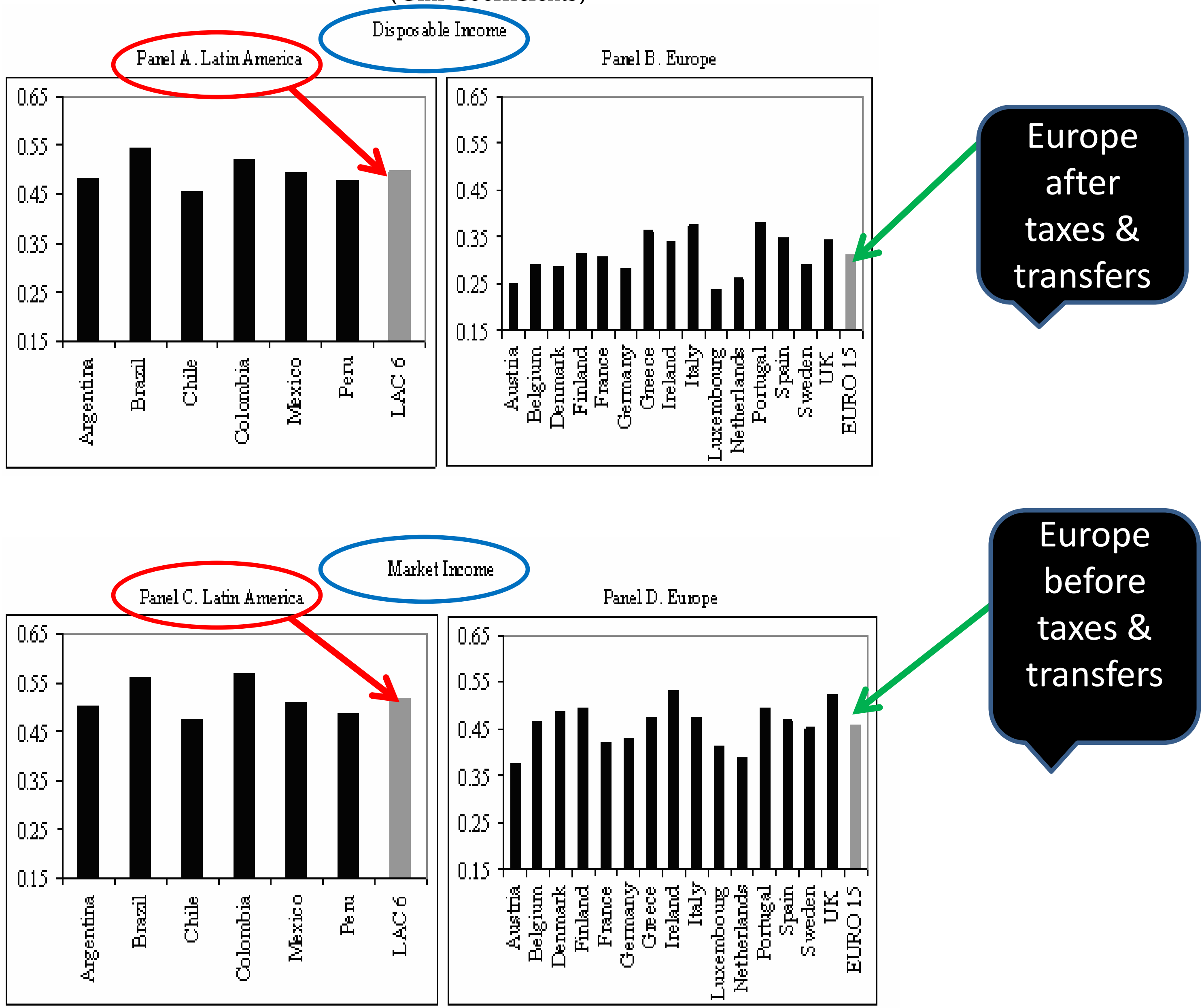
(Annual Change in Gini; Lopez-Calva & Lustig, 2011)



Gini Coefficient by Region (in %), 2004



Latin America and Europe: Disposable Income (After Taxes and Transfers) and Market Income (Pre-Taxes and Transfers) Inequality
(Gini Coefficients)



Source: Lopez and Perry (2007), p. 18.

Commitment to Equity Assessment (CEQ)

- Commitment to Equity Assessment (CEQ): A Diagnostic Framework to Evaluate Governments' Fiscal Policies
- Joint project by Inter-American Dialogue and Tulane; started in 2008; coordinator: Nora Lustig
- Pilot studies: Argentina (Carola Pessino, UTDT; Mexico (John Scott; CIDE); Peru (Miguel Jaramillo, GRADE)
- At present, 9 countries: Argentina, Bolivia, Brazil, Costa Rica, Guatemala, Mexico, Paraguay, Peru and Uruguay. Preliminary results for pilot cases

What is the Commitment to Equity Assessment?

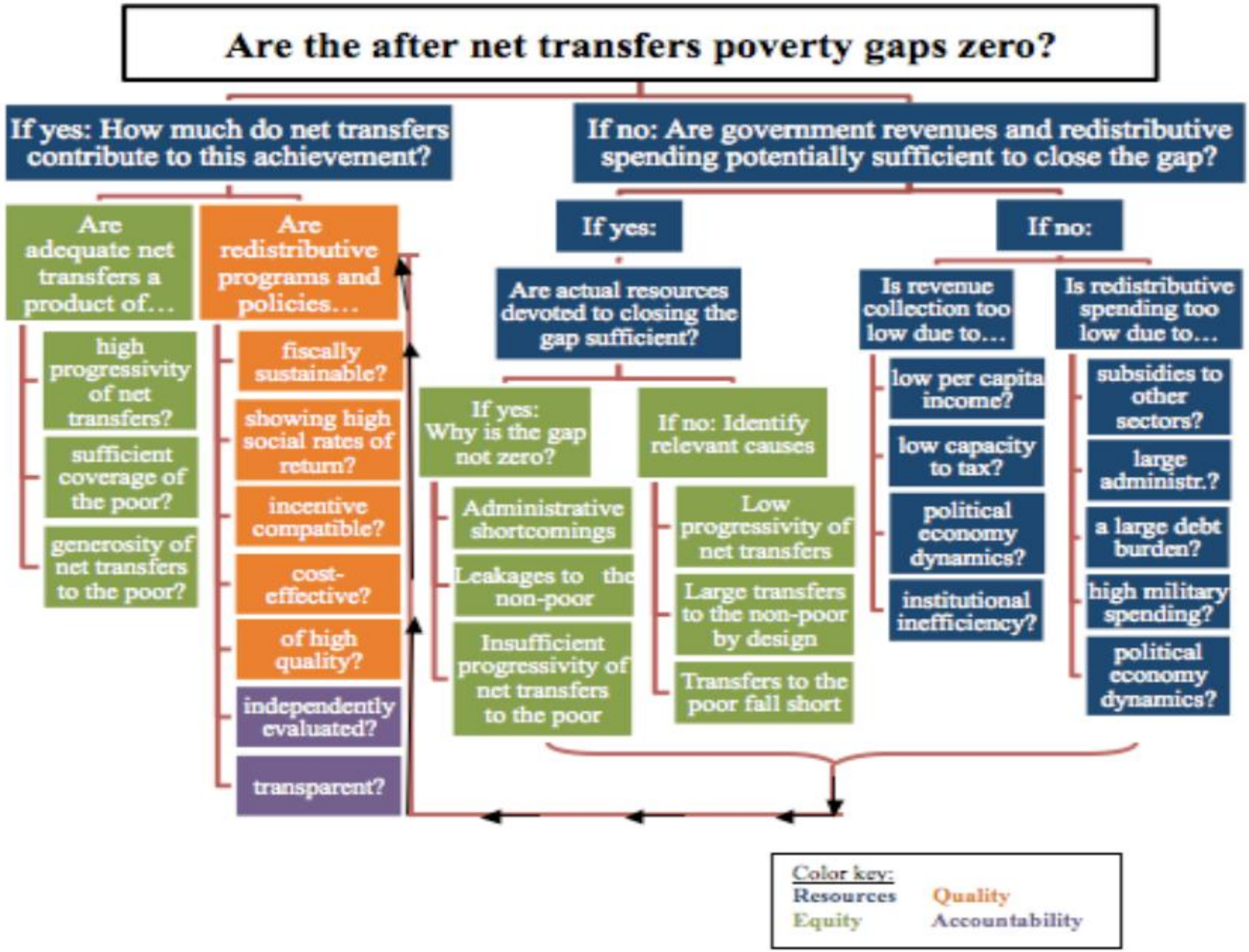
- A diagnostic framework to evaluate:
  - how aligned fiscal policies are with <u>supporting a minimum living standard</u>
  - in ways that reduce inequality and are broadly consistent with macroeconomic stability, microeconomic efficiency and growth
- An in-depth analysis by country and diagnostic and an index to rank governments' *commitment to equity*

CEQ evaluates efforts based on whether governments:

- RESOURCES: collect and allocate enough resources to support a minimum living standard for all
- EQUITY: collect and distribute resources equitably
- QUALITY: ensure spending is fiscally sustainable and that programs are incentive compatible
- ACCOUNTABILITY: collect and publish relevant information as well as are subject to independent evaluations

Suppose, as in most developing countries, that the poverty gap is not close to zero

- In searching for the causes, we follow a logical sequence that will help us to identify the contributing factors and binding constraints.
- In middle-income countries, insufficient total fiscal resources are not likely to be a cause for not bringing the poverty gaps close to zero.
- One possible cause is that within redistributive spending, fiscal resources devoted to the poor are not enough. There are at least three main reasons:
  - benefits to the non-poor are too high
  - coverage of the poor is not universal
  - average per capita transfers to the poor fall short


Are the after net transfers poverty gaps zero?
If yes: How much do net transfers contribute to this achievement?
If no: Are government revenues and redistributive spending potentially sufficient to close the gap?
Are adequate net transfers a product of…
high progressivity of net transfers?
sufficient coverage of the poor?
generosity of net transfers to the poor?
Are redistributive programs and policies…
fiscally sustainable?
showing high social rates of return?
incentive compatible?
cost-effective?
of high quality?
independently evaluated?
transparent?
If yes:
Are actual resources devoted to closing the gap sufficient?
If yes: Why is the gap not zero?
Administrative shortcomings
Leakages to the non-poor
Insufficient progressivity of net transfers to the poor
If no: Identify relevant causes
Low progressivity of net transfers
Large transfers to the non-poor by design
Transfers to the poor fall short
If no:
Is revenue collection too low due to…
low per capita income?
low capacity to tax?
political economy dynamics?
institutional inefficiency?
Is redistributive spending too low due to…
subsidies to other sectors?
large administr.?
a large debt burden?
high military spending?
political economy dynamics?
Color key:
Resources
Quality
Equity
Accountability

Products

- Methodological framework (handbook); Tulane Econ Dept's Working Paper

http://greenspace.tulane.edu/nlustig

- Excel template tables and graphs
- Paper by Jaramillo, Lustig, Pessino and Scott on Argentina, Mexico and Peru accepted for the Economic Inequality Society meeting in July

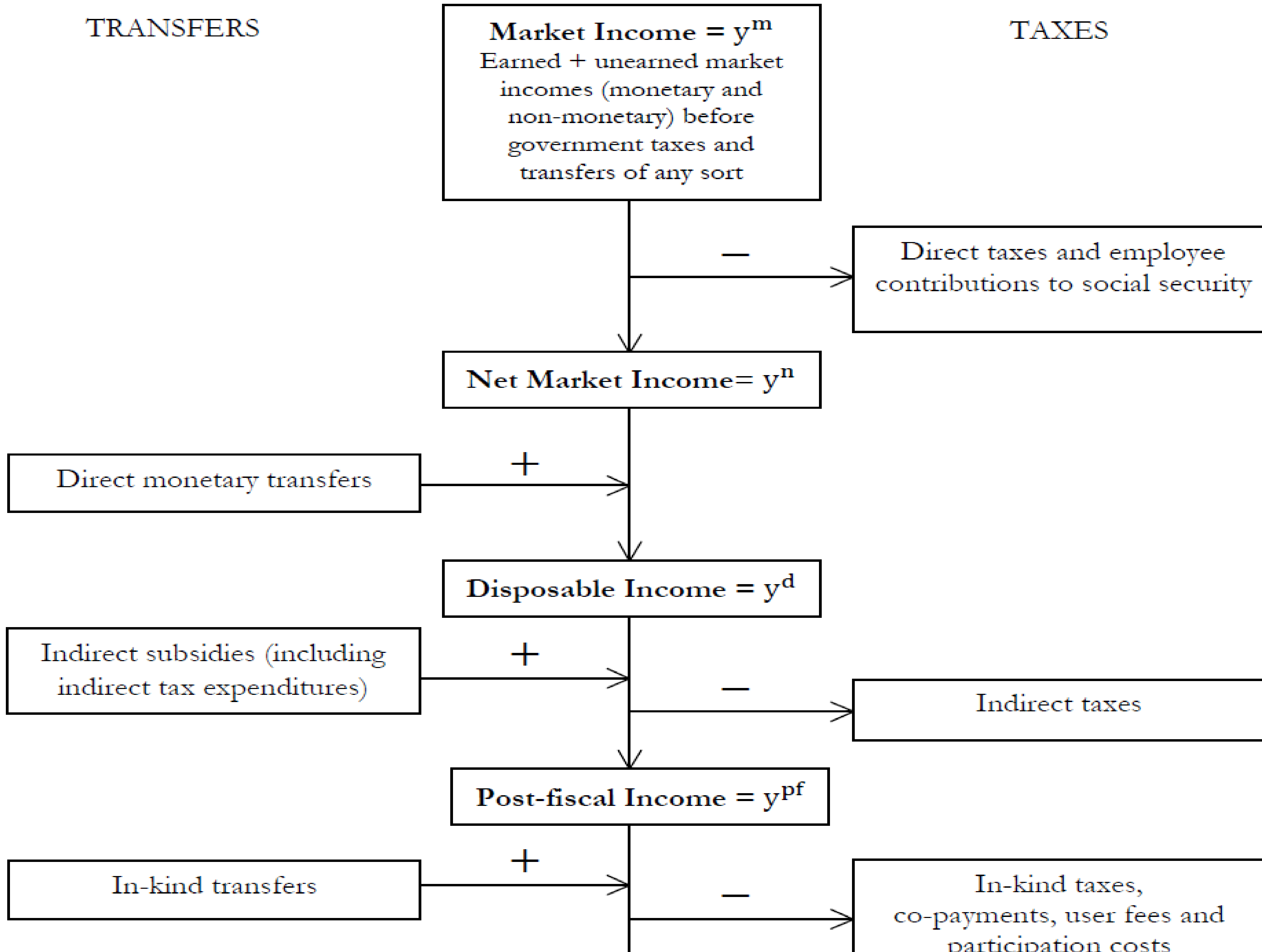
In progress:

- Book
- Index

What can we measure with existing data?

- Most common source: household surveys with important limitations:
  - Incomes measured in surveys:
    - Many countries capture incomes after (net) direct taxes and do not ask how much people pay in direct taxes
    - In some countries it is not clear whether reported incomes are before or after taxes
    - Some countries do not cover rural areas
    - Household surveys do not include consumption so incidence of indirect taxes cannot be estimated
  - Serious underreporting of top incomes

Figure 4 – Definitions of Income Concepts: A Stylized Presentation



Under-reporting of Top Incomes in Household Surveys

Average household monthly income of the two richest households in the surveys (2006):

- Argentina US$ 14,779
- Brazil US$ 70,357
- Mexico US$ 17,563

The Rich in Latin America: Estimates of Monthly Income (circa 2007-2009)

Merrill Lynch High Net Worth Individuals (HNWI) and Ultra-High Net Worth Individuals (UHNWI): 2007								
(in millions of dollars otherwise specified)								
	LATAM				**WORLD**			
	WEALTH**	**POP**	**AVE. WEALTH*****	**Monthy Inc*****	**WEALTH**	**POP**	**AVE. WEALTH*****	**Monthy Inc*****
HNWI (US$1 m or more in assets)*	$6,200,000	400000	$15,500,000	$64,583	$40,700,000	$10,100,000	$4,029,703	$16,790
UHNWI (US$30 m or more in assets)*	$2,200,000	4400	$500,000,000	$2,083,333	$14,300,000	$103,300	$138,431,752	$576,799
FORBES Billionaires in Latin America								
(in millions of dollars otherwise specified)								
30 billionaires (US$1 b or more in assets)	$115,000	30	$3,833,333,333	$15,972,222				
Carlos Slim			$35,000,000,000	$145,833,333				

Source: top panel Merrill Lynch and Capgemini World Wealth Report (2009); bottom panel *Forbes, April* 2009

Note: Population figures in units.

* Investible assets exclude primary residence, collectibles, consumables and consumer durables.

** total wealth for UHNWI in Latin America was assumed to be the same proportion of HNWI' wealth as for the world which equalled 35 percent.

*** in dollars per month. Author's estimates based on Merril Lynch and assumption **;
monthly returns were calculated assuming a yearly 5 percent return on investible assets.

Access to administrative tax returns of the essence

- Alvaredo, Atkinson, Piketty and Saez “Top Incomes in the World,” project and data base
- Estimated Inequality using tax returns for top incomes
- Information is available for all the advanced countries and some developing countries
- Latin American governments ARE RELUCTANT to submit the information, except for Argentina (until 2004)

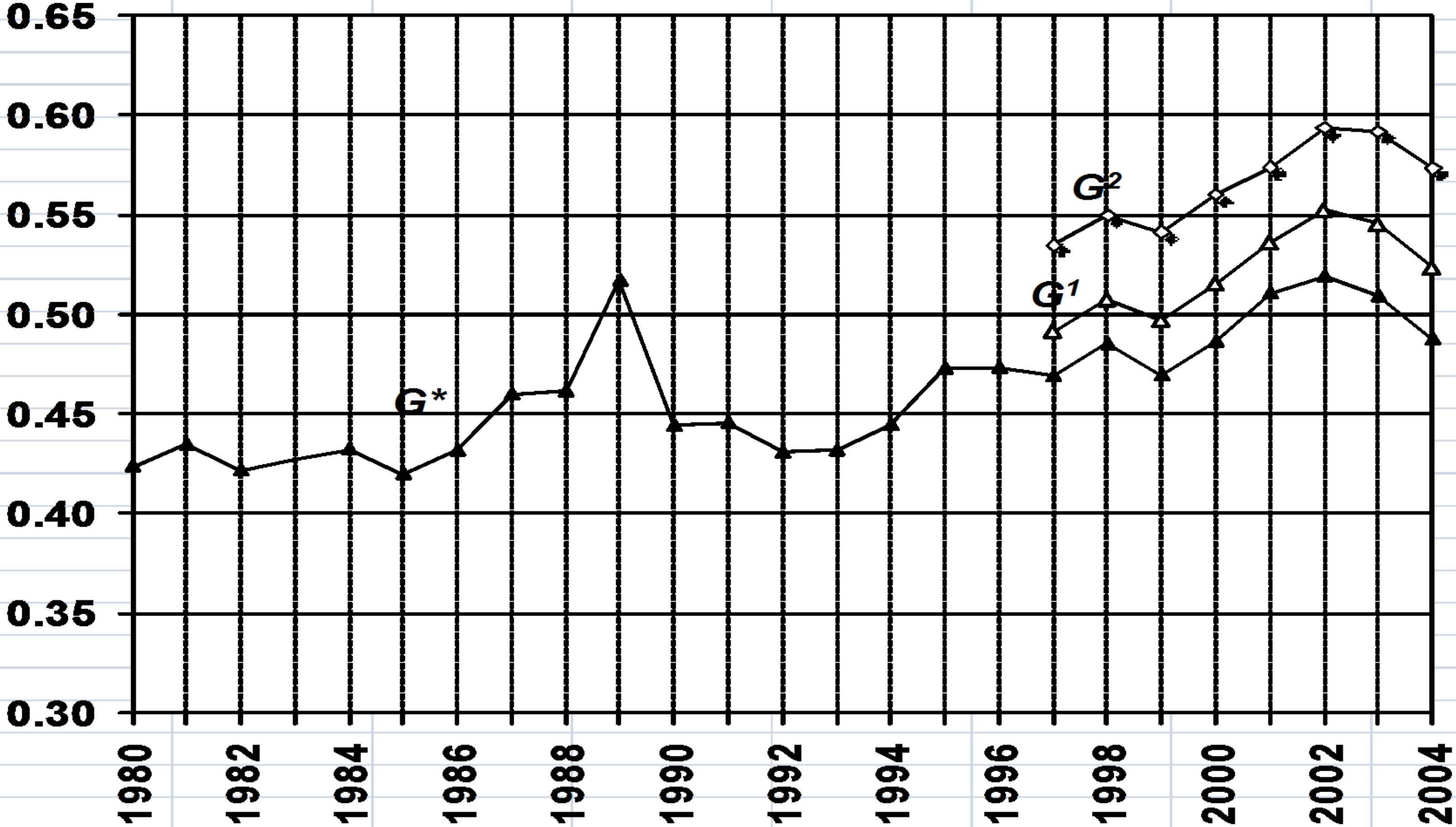


FIGURE 6

Gini coefficient in the Greater Buenos Aires 1980-2004

Methodological Issues

- Most Common Methodology: Static Benefits and Tax Incidence Analysis
- Limitations:
  - Behavioral and general equilibrium effects are not taken into account

Methodological Issues

- Establish a convention to define *Progressive* and *Regressive* taxes and transfers

- Literature is not homogenous; after review, CEQ adopted the following (next two slides); see Lustig (2011) for more details

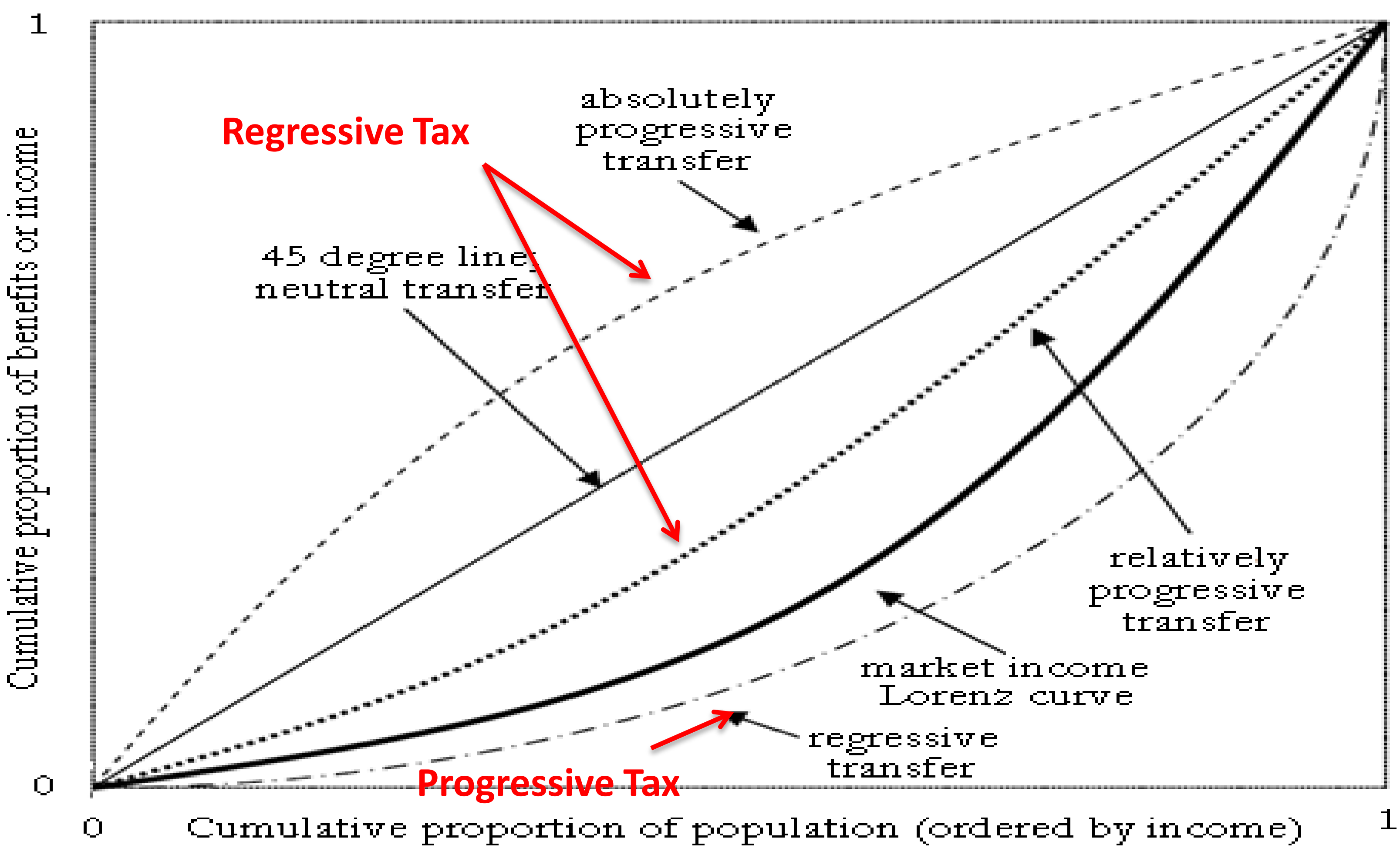
Definitions: Progressivity and Regressivity (Lustig, 2011)

	Taxes		Transfers	
	Relative	*Absolute*	*Relative*	*Absolute* (*also called "pro-poor"*)
Progressive	Poorer people pay lower taxes in relation to their income. Post-fiscal income is *more equal* than market income.		Poorer people get larger transfers in relation to their income. Post-fiscal income is *more equal* than market income but *less equal* than when transfers are also progressive in absolute terms.	Poorer people get larger transfers in per capita terms. Post-fiscal income is *more equal* than market income and than when transfers are progressive in relative terms. If transfers are progressive in absolute terms, by definition they are progressive in relative terms. The converse is not true.
Neutral	Everyone pays the same proportion of taxes in relation to their income. Market income and post-fiscal income distributions are the same.		Everyone receives the same proportion of transfers in relation to their income. Market and post-fiscal income distributions are the same.	

Definitions: Progressivity and Regressivity (Lustig, 2011), cont.

	Taxes		Transfers	
	Relative	*Absolute*	*Relative*	*Absolute* (*also called "pro-poor"*)
Regressive	Poorer people pay more taxes in relation to their income. Post-fiscal income is ***more unequal*** than market income but ***less unequal*** than when taxes are regressive in absolute terms.	Poorer people pay more taxes in per capita terms. Post-fiscal income is ***more unequal*** than market income and ***more unequal*** than when taxes are regressive in only relative terms. If taxes are regressive in absolute terms, by definition they are regressive in relative terms. The converse is not true.	Poorer people get smaller transfers in relation to their income. Post-fiscal income is ***more unequal*** than market income.	

Progressivity and Regressivity of Taxes and Transfers



CEQ: An application to Argentina, Mexico and Peru

- In Argentina and Mexico, government revenues and redistributive spending are sufficient to potentially eradicate the poverty and human capital gaps; this is not true for Peru.
- In Argentina and Mexico, where resources are sufficient, poverty gaps subsist because a large portion of fiscal resources are allocated to other areas within the public sector and to the non-poor.
- This is more conspicuous for Mexico than for Argentina. In all three countries, characteristics of the existing safety net system imply that there will be a large fraction of the poor excluded by design.
- The probability of remaining poor after transfers increases for males and poor people who are relatively more educated, younger, and –in Mexico and Peru—live in urban areas.


BULLET HOLES
Protests against a
tax increase in 2003
Plaza Trujillo, La Paz
Bolivia, May 2011

References

- Lustig, Nora *Commitment to Equity Assessment (CEQ). A Diagnostic Framework to Assess Governments' Fiscal Policies*, Dept. of Economics, Tulane University, Working Paper 1119, April 2011
- Jaramillo, M., N. Lustig, J. Scott and C. Pessino *Commitment to Equity: An Assessment of Fiscal Policies in Argentina, Mexico and Peru,* paper accepted to be presented at ECINEQ, University of Catania, Sicily, July 2011

Thank you