Tax Expenditures in Latin America: A Civil Society Perspective

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Paper

This publication was developed as part of the Latin America Tax Expenditure Research, Advocacy, and Learning (LATERAL) project. LATERAL is an innovative collaborative research, capacity-building, and advocacy initiative that was launched by the International Budget Partnership (IBP) and ten Latin American civil society organizations (CSOs) in 2016 to support CSO work on increasing the transparency, accountability and equity of tax expenditure policies at the country and regional levels.

LATERAL seeks to promote policy reform by shedding light on the impact of tax expenditures on inequality across the region, raising public awareness of the importance of the issue, and pursuing a coordinated advocacy effort both within individual countries and at the regional level. The project has undertaken analyses that compare tax expenditure policies and practices across the region and examine the impact of these policies and practices on inequality. The LATERAL project has fostered an energized regional community, where CSO members learn from and help each other improve research, advocacy and communication around tax issues.

The ten LATERAL project partners include:

- ACIJ - Asociación Civil por la Igualdad y la Justicia (Argentina)
- CAD – Ciudadanos al Día (Peru)
- Dejusticia (Colombia)
- ICEFI – Instituto Centroamericano de Estudios Fiscales (Guatemala)
- INESC – Instituto de Estudos Socioeconômicos (Brazil)
- ISD – Iniciativa Social para la Democracia (El Salvador)
- Fundación Solidaridad (Dominican Republic)
- Fundar – Centro de Análisis e Investigación (Mexico)
- Grupo Faro (Ecuador)
- Sonora Ciudadana (Mexico)

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BACKGROUND

Over the past few years, a group of Latin American civil society organizations, facilitated and coordinated by the International Budget Partnership (IBP), have come together in a project to promote research, advocacy and learning around tax expenditures – i.e., exemptions and incentives of different kinds that reduce the amount of revenues collected by governments – across Latin America, and to better understand how their impact on inequality can be assessed. The policies of fiscal austerity that are being promoted across the continent rarely include discussions on reforming or reducing the fiscal privileges which governments distribute through tax expenditures, or a clear assessment of the latter's expected benefits or impact on income distribution. Given their opaqueness, civil society has not had a strong voice on these matters in the past, but the increasing amount of information that is being made publicly available, and the urgency of the fiscal crisis that many countries face, calls for more debate and action in this area.

This paper summarizes the findings from two components of this project: one that looked at tax policy and tax expenditures in Latin America and the role that civil society can play in related debates (presented in a series of more general background papers and guides[1]), and another that involved country-level research carried out by civil society groups in more than nine countries in the region.[2]

Our introductory section below provides contextual information on taxation and on tax policy in Latin America and is followed by a section that presents basic data and information on tax expenditures across the region. Subsequent sections bring together the findings from country-level research carried out by the participating groups and focus on the public availability of information on different aspects of tax expenditures, on the process through which decisions are taken around their approval and adoption, and on the effectiveness of tax expenditures in reaching their expected objectives. The final section of this paper highlights some of the main challenges ahead and points to possible directions for future work in this area.

[1] These background documents can be found on the project web page: https://www.internationalbudget.org/content/lateral-project/.

[2] The groups are ACIJ (Argentina), Inesc (Brazil), DeJusticia (Colombia), Fundaciòn Solidaridad (Dominican Republic), Grupo Faro (Ecuador), Fundar and Sonora (Mexico), CAD (Peru), ICEFI (Central America) and ISD (El Salvador), who joined the project more recently.

INTRODUCTION

TAXATION – A FUNDAMENTAL FISCAL POLICY TOOL

Ever since some form of government has existed, taxation has been a defining feature of collective life, and one that has always raised some controversy. The earliest known tax records date back to 6000 BC in Ancient Mesopotamia, where an anonymous inscription on a clay tablet was found saying: "You can have a Lord, you can have a King, but the man to fear is the tax collector".[3] Many centuries later, Benjamin Franklin famously said that taxes are one of only two things that are certain in this world. The other one is death. While in ancient times taxes were collected forcibly by rulers to finance wars, today's modern states rely on citizens to willingly pay a share of their income in exchange for the provision of a broad array of public goods and services, which still include national defense but over time have come to cover many spheres of life, from health and education to pensions and other benefits, and from environmental protection to the regulation and promotion of economic activity and employment. Taxes and revenue collection can therefore be considered as one of the key pillars of today's states and societies, and of the social contract that binds them together.

The goals of taxation, or the objectives that governments pursue – or should pursue – when taking tax policy decisions can be classified according to the "4 Rs" proposed by Cobham (2005). These are:

1. **Revenue** generation, or raising the necessary resources to finance public spending;
2. **Redistribution** of resources to limit inequality and reduce poverty;
3. **Representation** as the key building block of state-citizen relations and accountability;
4. **Re-pricing** of economic alternatives as a tool to influence the behavior of individual and corporate actors (for example, incentivizing savings or reducing pollution).

The varied and ambitious nature of these objectives turns taxation into a fundamental area of policy-making and of development strategies, which has often gone unrecognized or underestimated. In recent years, however, taxation has received increased attention, for a variety of reasons. The United Nations' Agenda 2030 has put the mobilization of domestic resources through taxation at the heart of strategies for achieving the Sustainable Development Goals, calling on governments and on the international community to take concrete steps to improve revenue collection and revenue administration, especially in lower income countries. At the same time, there is increasing evidence – for example based on international reporting on the *Panama Papers* and the *Paradise Papers* – on the many schemes and loopholes that allow ultra-rich individuals and multinational corporations to avoid paying taxes by setting up complex cross-border structures and stashing money away in

[3] See Carlson (2004).

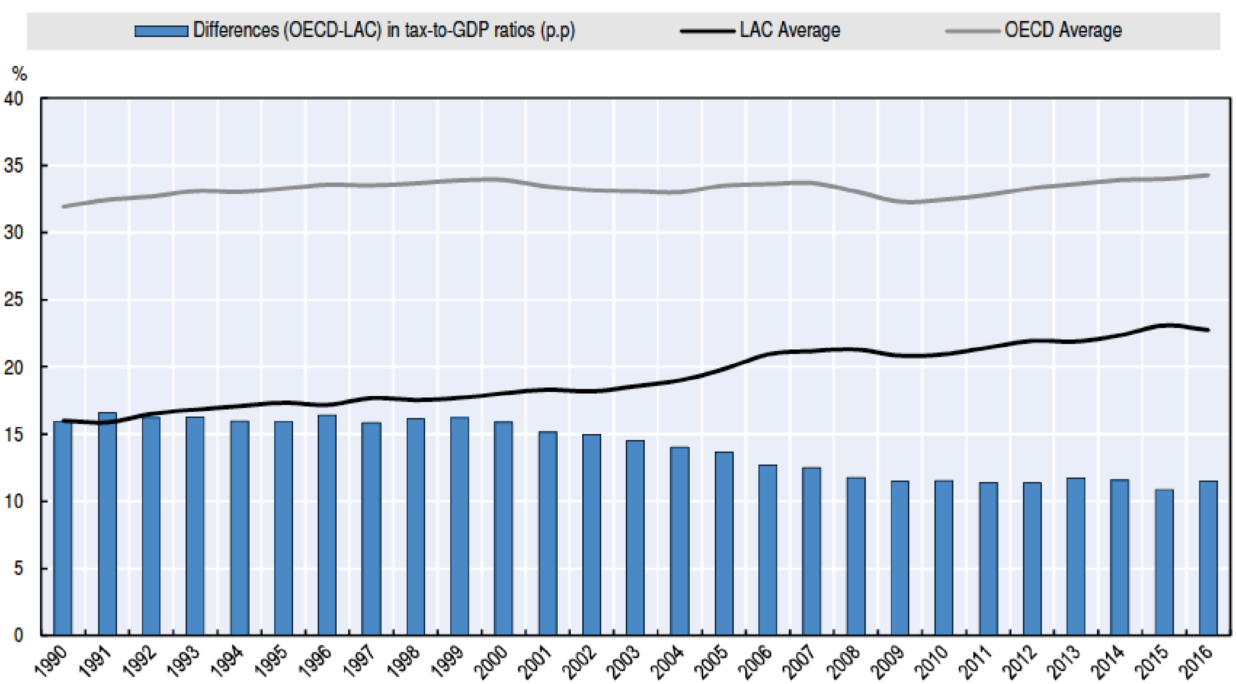
opaque fiscal heavens. On one hand, taxation and fiscal policy are seen as fundamental tools in promoting development. On the other, in an era of increasing complexity brought about by globalization, tax systems are used and gamed for the benefit of a few rather than all citizens, seemingly unable to pursue their intended objectives effectively.

In particular, the issue of who bears the costs and who benefits from existing tax policies, and the implications of such distribution on poverty, inequality and human rights is one that has been a topic of increased debate, both globally and in Latin America, a region that despite some recent improvements remains one of the most unequal in the world.

TAX POLICY IN LATIN AMERICA – GENERAL PARAMETERS

Looking at some basic data on taxation across countries, a few important observations immediately become apparent. Figure 1 shows that on average Latin American countries collect lower revenues as a share of Gross Domestic Product (GDP) when compared to OECD-member countries. Despite a clear and steady increase in tax/GDP ratios for the region over the past 25 years, and the gradual convergence towards OECD levels, the difference is still larger than ten percentage points.

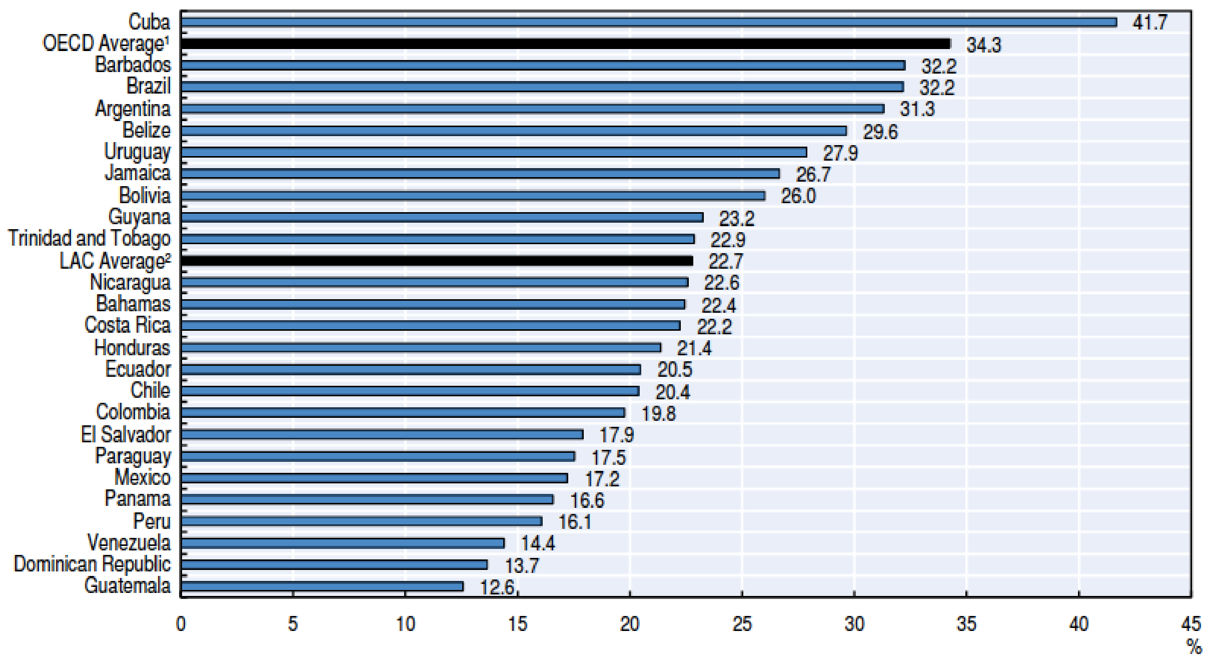
FIGURE 1. TAX/GDP RATIOS, LAC AND OECD AVERAGES, 1990-2016



Source: OECD et al. (2018)

These average levels hide great variation. As Figure 2 shows, countries like Brazil and Argentina collect tax revenues that are worth more than 30 percent of GDP, while tax revenues in Guatemala and the Dominican Republic do not even reach half of that amount. Clearly, the capacity of governments in these countries to deliver services and tackle inequality is going to be very different.

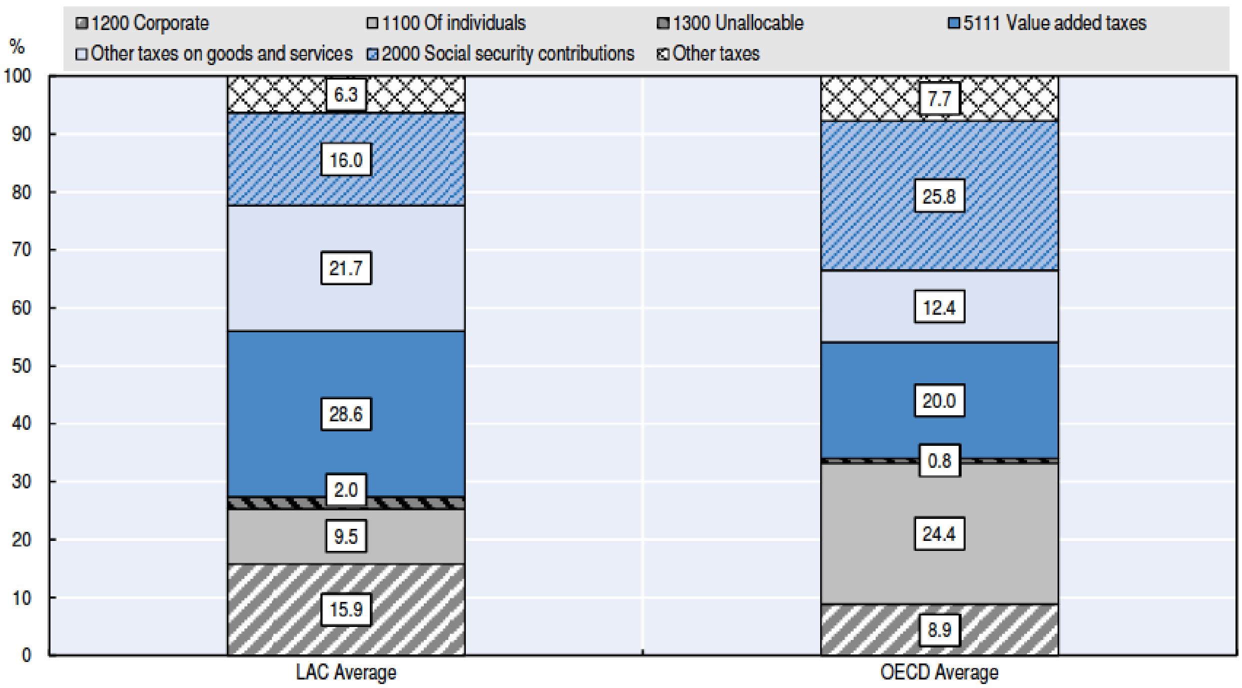
FIGURE 2. TOTAL TAX REVENUE AS % OF GDP IN LAC COUNTRIES, 2016



Source: OECD et al. (2018)

Not only do Latin American countries raise fewer revenues on average than their OECD counterparts, but the composition of those taxes is also very different. As shown in Figure 3, countries in Latin America raise a much larger percentage of their tax revenues from indirect taxes – such as consumption taxes – than OECD countries. As these taxes are often considered to be more regressive, given that poorer households spend a larger share of their income on consumption – this makes it more difficult for Latin American governments to tackle inequality through taxation alone.

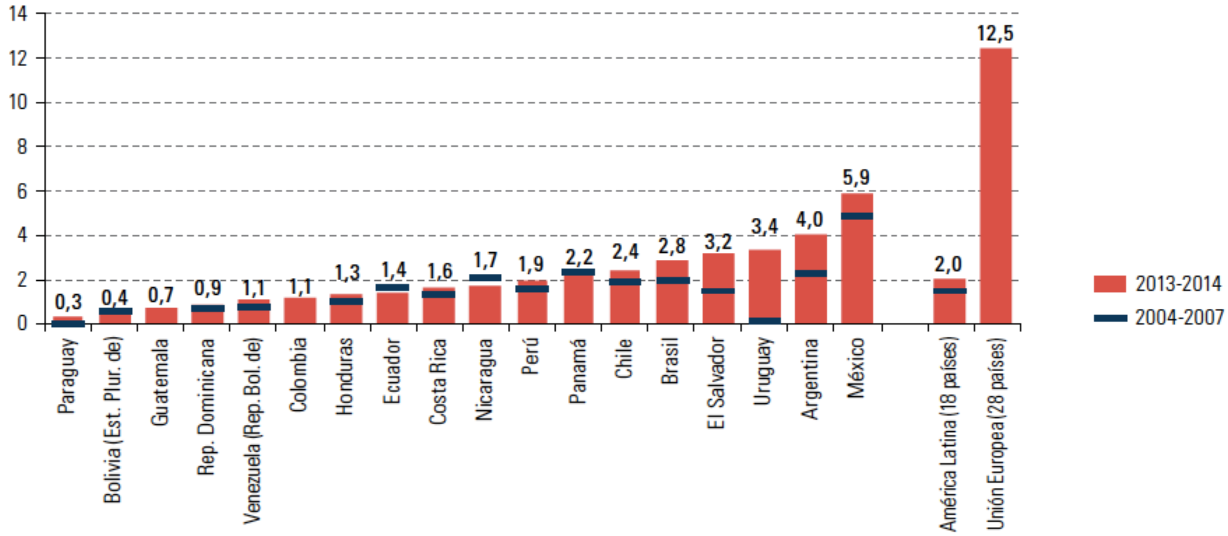
FIGURE 3. TAX STRUCTURE (AS A % OF TOTAL TAX REVENUE) IN THE LAC AND OECD REGIONS, 2015



Source: OECD et al. (2018)

Moreover, even when looking at the direct taxation of personal income, which has a much larger potential for redistribution, Latin American countries are not able to use it as a tool for reducing inequality as much as countries in Europe do, for example. Figure 4 shows the reduction in the Gini coefficient brought about by the taxation of personal income across the region, and compares the regional average to the same average across the European Union. As can be seen, despite the progress that was made, in Europe personal income taxation is about six times more effective in reducing inequality than in Latin America.

FIGURE 4. GINI COEFFICIENT REDUCTION DUE TO PERSONAL INCOME TAXATION (%)



Source: CEPAL (2017)

While revealing of broader trends, the facts and figures presented above only present a partial picture of what is really happening in terms of fiscal policy and its impact on inequality in Latin America. Too often, research and debates around taxation do not take into account the fact that governments use tax expenditures as an additional instrument of fiscal policy. Tax expenditures, as this paper will show, constitute a large (and often growing) burden on the public purse, and are often managed outside the regular budget process, reducing both transparency and regular oversight, with important implications for income distribution and economic development more broadly.

WHAT ARE TAX EXPENDITURES, AND WHY ARE THEY IMPORTANT?

Tax expenditures can be defined in different ways. The recently revised *Fiscal Transparency Handbook* produced by the IMF defines tax expenditures as:

> *"Revenue foregone, attributable to provisions in the tax law that allow special exclusions, exemptions, deductions, credits, concessions, preferential rates, or deferral of tax liabilities for select groups of taxpayers or specific activities. These exceptions may be regarded as alternatives to other policy instruments, such as spending or regulatory programs."* (IMF 2018: 143)

As an example, governments may decide to promote a certain economic sector through an ad-hoc reduction in the taxes that should normally be paid in that sector, rather than through a direct subsidy. All such deviations and exceptions from the normal tax system – also called "benchmark" – which benefit certain individuals or sectors correspond to a reduction in the taxes that governments would normally collect, or to an equivalent item of spending that could be used for the same purpose.

According to Villela et al. (2010), governments use tax expenditures to pursue a few different objectives, not very different from the ones identified above for taxation as a whole (the "4Rs"). These are:

1. **Improving progressivity within the tax system** by reducing tax payments for lower income households, through for example exempting poor people from paying income tax or zero-rating basic food items in Value Added Tax (VAT) schedules.
2. **Provide greater efficiency to the tax structure**, by stimulating savings and investment through different types of tax reductions and credits, for example on reinvested profits or on interests earned on certain financial instruments.
3. **Stimulate the consumption of merit goods** like health and education, or support to charities. This is usually done through preferential treatments applied to income tax, where spending on such items can be deducted from the taxable base.
4. **Promote regional or sectoral development**, directing industrial policy through the provision of targeted fiscal incentives to attract foreign direct investment or to promote domestic investment in certain sectors or regions.

Arguments in favor of using tax expenditures focus on their apparent efficiency and simplicity (Swift et al. 2004; OECD 2010). Rather than government having to set up institutions to collect revenues and to administer spending, it can simply reduce the taxes it collects from certain types of taxpayers, therefore saving and simplifying on both sides. Moreover, tax expenditures might be considered more efficient by ultimately allowing taxpayers to take their own decisions on certain activities like spending on health and investment, rather than attempt to centrally plan various aspects of economic life. Yet, these advantages are generally considered to be more than offset by the many drawbacks of tax expenditures, which include their lack of transparency and accountability, the complexity that they introduce in the tax code, the fact that they are often prone to abuse, and their potential negative impact on both horizontal and vertical equity (Villela et al. 2010).

Governments have been using tax expenditures as a tool of fiscal policy for a long time, but the push for better monitoring and regular reporting on such provisions is more recent. Tax expenditure reporting was first adopted in the 1960s, almost simultaneously in Germany and in the United States (Villela et al. 2010) and has since spread across the world. In Latin America, the first tax expenditure reports appeared in Brazil in 1989, while Paraguay only started publishing such reports in 2015. While practically all governments now publish such reports, not all of them do so as a regular part of the yearly budget submission to the legislature (see Table 1 below).

TABLE 1. TAX EXPENDITURE REPORTING IN LATIN AMERICA

	Year in which measurements were institutionalized	Tax expenditure report attached to proposed budget	Tax expenditure reports are publicly available
Argentina	1999	Yes	Yes
Bolivia	2013	No	Yes
Brazil	1989	Yes	Yes
Chile	2001	Yes	Yes
Colombia	2004	Yes	Yes
Costa Rica	2011	No	Yes
Dominican Republic	2008	Yes	Yes
Ecuador	2010	Yes	Yes
El Salvador	2013	No	No
Guatemala	2002	Yes	Yes
México	2002	Yes	Yes
Paraguay	2015	Yes	Yes
Perú	2002	Yes	Yes
Uruguay	2008	No	Yes

Source: National tax offices and Inter-American Center on Tax Administrations - CIAT, https://www.ciat.org/.

Because governments define and calculate the value of tax expenditures in different ways, it is difficult to compare tax expenditures across countries. Not only are there different ways in which tax expenditures can be (and are) defined, but there are also various methods that can be used to put a value on different types of tax expenditures (CIAT 2011). Nonetheless, the Inter-American Center on Tax Administration (CIAT) usefully produces some comparable statistics.[4] In Table 2 below, these are brought together with some other estimates to provide an overall – if not fully reliable – picture of the size of tax expenditures across Latin America over the past decade or so. The figures are very interesting, and attest to the importance of bringing tax expenditures into public debates on fiscal policies. In most countries, tax expenditures have increased as a share of GDP since 2005, and their overall value oscillates mostly between 2 and 6 percent of GDP, with the greatest share being related to VAT and income taxation (CIAT 2017). This means that in any country, depending on the overall size of the state, tax expenditures can represent between 10 and 20 percent of total government revenues. In fact, data presented by Trigueros

[4] It is interesting to note that similar comparative datasets are not available for OECD countries. The most recent OECD publication on tax expenditures dates back to 2010, and for most countries includes data for 3-5 years only. See OECD (2010).

(2014) show that in countries like Guatemala, Costa Rica and Dominican Republic, in the period 2008-2012 that figure was much higher, at above 40 percent.

TABLE 2. TAX EXPENDITURES AS A PERCENTAGE OF GDP IN LATIN AMERICAN COUNTRIES, 2005-2016

Country	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
Argentina	2.2	2.1	2.2	2.14	2.1	2.0	2.5	2.5	2.5	2.5	2.9	2.8
Brazil	1.7	2.0	2.3	2.77	3.2	3.4	3.0	3.2	3.4	4.5	4.8	4.4
Chile	4.4	4.1	4.9	5.3	5.1	5.0	5.1	4.5	4.9	4.3	4.5	4.3
Colombia	3.7	4.0	3.5	3.2	3.2	3.2	3.7	3.4	…	…	…	…
Costa Rica	…	…	…	…	…	5.5	5.5	5.6	…	5.1	5.2	5.1
Dominican Rep	…	…	…	6.4	6.2	5.5	5.1	5.1	…	…	6.8	6.6
Ecuador	…	…	…	…	4.2	4.2	4.7	4.9	4.7	4.1	…	…
El Salvador	…	…	…	…	…	3.4	3.1	3.9	3.0	…	…	…
Guatemala	…	…	…	…	…	…	…	6.7	2.6	2.5	2.5	…
Honduras	…	…	…	…	…	…	6.2	6.5	…	…	6.7	6.5
Mexico	6.3	5.6	5.4	5.7	3.9	4.3	5.1	5.9	3.9	3.3	2.9	2.9
Panama	…	…	…	…	…	…	…	2.7	…	…	…	…
Paraguay	…	…	…	1.9	1.8	1.9	…	…	1.73	1.9	1.7	1.7
Peru	2.1	2.2	2.2	2.1	1.8	2.1	2.0	1.9	-	2.2	2.3	2.2
Uruguay	4.4	4.2	4.3	5.7	5.7	6.3	6.3	6.4	6.4	6.3		

Sources: Various, including Gomez-Sabaini and Moran (2014); Trigueros (2014); and CIAT (2017).

The impact of tax expenditures on inequality, one of the main themes of the project that this paper draws on, has not received a lot of attention so far. As reported by Martorano (2018), the literature on this topic is quite limited, but the emerging consensus is that tax expenditures can be detrimental to both horizontal and vertical equity. Tax expenditures may increase horizontal inequality because taxpayers in similar circumstances are treated differently according to specific deviations from the law. They can also affect vertical inequality due to their impact on different levels of the distribution of income. Tax expenditures in personal income taxes, for example, are often regressive due to the fact that concessions on taxable income will tend to benefit the better off in society, whose tax burden is higher. Martorano (2018) presents data on the impact of personal income tax expenditures in Ecuador and Chile which show that an overwhelming majority of the benefits went to the highest income individuals. Looking at other regions of the world, similar findings are reported for Poland in Cavalcanti and Swift (2004). A study of tax expenditures on personal income in six European countries, however, finds that the effect can vary from country to country, depending on the type of tax expenditure used – tax allowances or tax credits (Avram 2017). In addition to their direct impact on inequality, tax expenditures may also indirectly affect inequality by limiting the resources available to government for spending aimed at benefitting lower income citizens and households (Ross 2018a). Clearly, none of the above findings can be generalized, as tax expenditures can be designed to both reduce and increase inequality, and calculating their impact on income distribution is not an easy undertaking. Their actual impact therefore needs to be looked at on a case by case basis.[5]

In summary, tax expenditures are an important and controversial area of fiscal policy which has gone unscrutinized for a long time, but which has been receiving increasing attention in recent years. Nothing is wrong in principle with tax expenditures, as they can be used for promoting a number of important policy objectives like making the tax system more progressive or promoting investment in poor areas to stimulate development. In practice, however, their role as a fiscal policy tool is controversial, as they are often perceived to be used ineffectively and for political purposes, and as unequally benefitting richer and more powerful actors, without adequate scrutiny and accountability. Given their significance in terms of foregone revenues that could be used for alternative purposes, it is important for civil society groups to understand how they work and push for governments to use them more effectively to promote more equitable development and realize human rights.

KEY FINDINGS FROM CIVIL SOCIETY-LED COUNTRY RESEARCH IN LATIN AMERICA

This section brings together findings from country-level research carried out by the ten civil society organizations involved in the LATERAL project.[6] The research did not have a strict common focus across countries, but was rather based on each organization's own agenda and capacities, and on the level of access to relevant information in each country. Some of the studies focused more simply on a stock-take of available information on tax expenditures (Dominican Republic, Ecuador, Peru) while others looked at ways to assess the impact of some tax expenditures on inequality, income distribution and human rights (Argentina, Colombia, Mexico) or at more specific aspects of tax expenditures like fiscal incentives for investment (Brazil, El Salvador, and countries across Central America).

Broadly speaking, the findings can be grouped into three main headings: (1) issues of transparency and access to relevant information; (2) issues related to decision-making processes around tax expenditures; and (3) issues around the impact of tax expenditures.

[5] A study of the impact of tax expenditures on equity in four sectors across EU countries comes to the same conclusion, highlighting how the progressive or regressive nature of different types of tax expenditures depends on the country considered and on how the analysis is done (Barrios et al., 2016).

[6] See the list of country papers in the Sources section below.

TRANSPARENCY AND ACCESS TO INFORMATION: INSUFFICIENT TO ALLOW FOR PROPER ASSESSMENT AND DELIBERATION

As already highlighted in a previous section, our researchers confirmed that all governments that the studies reviewed produced and published some information on tax expenditures, either in separate reports or as part of other budget documents. As a consequence, all groups could access basic data on the value and composition of tax expenditures in their countries. What varies significantly, however, are the definitions of tax expenditures used in such reports, and the coverage and level of detail of the information provided. In El Salvador, for example, the information included in the *Marco Fiscal de Mediano Plazo*, an annual fiscal policy document published in recent years, only looks at tax expenditures related to VAT and income taxation, leaving it unclear whether there are other types of tax expenditures which are excluded from the calculations. In Argentina, despite the fact that the government decree regulating the fiscal responsibility regime provides an extensive definition of tax expenditures, the information published by government adopts a much more restrictive definition, excluding some of the main income tax deductions and some VAT exemptions, therefore underestimating the overall amount of tax expenditures.

Existing guidelines on what information governments should publish on tax expenditures (IBP 2011, IMF 2018) indicate that ideally such information should be published annually and include not just the overall cost, but a detailed breakdown by individual tax expenditure, including additional information on: (a) its legal source and expected duration (or "sunset clause"); (b) the definition of the benchmark against which it was assessed and the measurement method utilized; (c) a grouping by sector or policy area; and (d) its intended policy objective and an assessment of its impact, including distributional impact. Practices across the countries covered by this project vary, but tend to satisfy the earlier criteria more than the latter ones. In particular, very few governments report on the policy objectives of tax expenditures, and hardly any publish results of evaluations of their impact, even in cases like Mexico where such information is required by law.

Some interesting findings coming out of the analyses of available information carried out by the groups include:

- Few countries publish information on the **end-dates of tax expenditure provisions**, and, in fact, in many countries these are either not determined, meaning that tax expenditures are expected to remain in place indefinitely, or they are set for a very distant future date. In Argentina, ACIJ reported that only 12 percent of the more than 400 tax expenditures identified in the period 2010-2016 had a stipulated end-date. In Colombia, the share of unlimited tax expenditure provisions was 75 percent, with no proper justification provided. In Brazil, fiscal incentives for the Amazon region are expected to remain in place for the next 50 years. Without regular evaluations and reviews, of which there is no evidence in the countries covered, it becomes very difficult to properly assess and realize the benefits of these provisions.

- Some countries, like Argentina, Brazil and Peru, publish additional information related to the **territorial distribution of tax expenditures**, something which makes sense when there are less developed regions – like the Amazon regions in Brazil and Peru, or the extreme south in Argentina – that are targeted for specific fiscal incentives aimed at promoting investment and development.

- As highlighted above, there is a **general scarcity of evaluation information** published by governments. Colombia was the only country where the local partner found a government-sponsored evaluation of the impact of fiscal incentives in special economic zones (*zonas francas*) which was published in 2012. The other case where some interesting information on the distributional impact of specific tax expenditures is published is Mexico. The Mexican tax expenditure report includes a breakdown of who benefits from 11 different types of tax expenditures by income decile. These are mostly linked to health and education – such as deductions on personal income tax for school transport or health insurance premiums, or VAT zero-rates on medicines.

- Finally, a number of groups highlighted the **lack of access to information on beneficiaries of tax expenditures**, which would be very important to evaluate tax expenditures and their impact, especially when it involves large companies with access to substantial tax breaks. Tax secrecy is usually applied as a blanket justification for not sharing details of beneficiaries of tax expenditures, often beyond reasonable limits.

In general, the research shows that while there are established practices across Latin America for regular reporting on tax expenditures, publicly available information is far from sufficient to provide adequate public justification on the foundation and rationale for tax expenditures, and to allow for proper democratic debate and deliberation on their adequacy and impact as fiscal policy tools.

DECISION-MAKING PROCESSES: OPAQUE, CLOSED AND PRONE TO ABUSE

Despite being based on legal provisions, tax expenditures constitute ad hoc exceptions to the tax code which are usually not negotiated and decided upon as part of the regular budget process. This means that decision-making around their design and approval is mostly opaque and prone to lobbying by powerful interest groups, despite their more general and substantial implications for budget policy. This is exacerbated by the fact that one-off decisions can have fiscal consequences over a long period of time, depending on whether tax expenditure provisions are introduced for a fixed and / or lengthy period and on what procedures are put in place for reviewing them.

Most groups commented on the difficulties they faced in even understanding how the decision-making process around tax expenditures works, let alone being able to influence it. In Brazil, fiscal incentives for companies investing in the Amazon region have been in place since the 1960s and 1970s. Despite many successive scandals and failures to bring about the expected impact, the government has kept renewing them until today, without any serious evaluation of their impact, objectives or *modus operandi*. Such lack of openness is often the case not just of tax expenditures, but of fiscal policies and tax reforms more generally. Recent fiscal reform efforts in Colombia and Argentina illustrate these challenges well. In Colombia, the 2016 tax reforms were originally based on an assessment carried out by an Expert Commission for Tax Equity and Competitiveness. One of the recommendations that the Commission put forward was to lower corporate income taxes, but concurrently eliminate all tax benefits. During negotiations, the tax reduction was retained, but the tax benefits were not eliminated – and were in fact expanded after intense lobbying – despite the Ministry of Finance's recognition that many of these benefits create distortions and inequities. In Argentina, also as part of a recent fiscal reform process, a Bicameral Commission was created to oversee the formulation of the reform package, and ensure adequate consultation and participation by various stakeholders, including civil society. A formal request for dialogue was presented by a group of civil society organizations, but this request was ignored and the reforms were passed in a rush in December of last year, without opening any spaces for public consultation or participation.

In the absence of sufficiently detailed information, and in the face of closed decision-making processes which are prone to abuse and corruption, it may come as no surprise that evidence on the impact of tax expenditures – the topic of the next section – is often negative, when it exists at all.

IMPACT: DIFFICULT TO ASSESS AND OFTEN LIMITED

If evaluating the cost of tax expenditures in terms of foregone revenue is already considered to be a challenging task, evaluating their overall costs and benefits to society as a whole – for example in terms of their impact on the objectives that they are intended to pursue – is more complicated still. This might be one of the reasons why few governments produce – let alone publish – such evaluations. These evaluations may require very detailed data and sophisticated techniques, putting civil society groups interested in these issues at a disadvantage. If governments do not produce such evaluations, or do not publish the data necessary for others to produce them, ensuring a well-informed and evidence-based discussion on tax expenditures is likely to be difficult. An examination of the impact of tax expenditures needs to take into account both their direct and indirect effects. In principle, understanding the impact of VAT exemptions for basic food items, for example, on income distribution requires information on how much taxpayers at different levels of income would have paid with and without the exemptions, but also on how much such exemptions affected their consumption decisions. Similarly, measuring the impact of fiscal incentives on investment requires estimating not just the taxes that companies would have paid, but also what investment decisions they would have taken in the absence of the incentives, for example through micro-simulation models (IMF et al. 2015; OECD 2010).

These comprehensive evaluation methods were clearly beyond the scope of the studies that were undertaken as part of the project. Rather, the evidence presented by civil society groups from across Latin America is based on other, simpler ways to go about probing and assessing the impact of tax expenditures despite the absence of the necessary detailed data. Most of them looked at either (a) the effectiveness of fiscal incentives for promoting investments, particularly those given to Special Economic Zones (*zonas francas*); or (b) the impact of different types of income tax deductions and exemptions on income distribution.

A regional study of Central America questioned the commonly held view that favorable fiscal regimes are key to attracting investment. It found that most countries in the region have very similar (and substantial) investment incentives in place, making them less relevant for investment decisions from a regional perspective. Governments do not carry out ex-ante cost-benefit analyses of proposed investment incentives, leaving decisions dependent on lobbies and political considerations. And despite the large investment incentives provided, economic results do not seem to uphold the view that such incentives made a difference in terms of promoting economic growth or job creation. In fact, they show that economic sectors that grew the most were not the ones that received the incentives, and that unemployment levels remained constant or increased, while the size of the informal sector did not decrease. In other words, while it may not be possible to provide a detailed evaluation of each specific type of tax expenditure, and to know what would have happened without them, a more general assessment of the effectiveness of a broad range of fiscal incentives on the economic variables that they are supposed to affect can still be considered as legitimate and important evidence in the debate on the impact of tax expenditures.

A similar case is presented in Colombia, where the government itself recognized that empirical evidence showed that the effect of fiscal incentives for *zonas francas* were not as positive as expected. This was based on a study by Meléndez and Galindo (2010) that found no evidence that the introduction of a tax incentive for firms that invest in fixed assets was effective in promoting such investments in Colombia. Furthermore, the already mentioned Expert Commission tasked with coming up with proposals for tax reform stated that beyond their significant fiscal cost, which does not seem to be compensated by higher investment and generation of future revenues, *zonas francas* generate economic distortions and horizontal inequality because they benefit specific companies over others which directly compete with them and do not have access to such benefits.

Both the Central America and Colombia stories cite and reinforce existing evidence about the limited influence that fiscal incentives may actually have on the investment decisions that companies take, despite the fact that governments often use this argument to justify tax expenditures of this kind. A few international surveys of large companies have shown that tax regimes actually score fairly low among the key factors shaping decisions about where to invest, well below other factors such as access to markets, institutional stability and predictability, quality of infrastructure, the presence of a qualified workforce, and so on.7 In other words, the evidence points to the fact that in order to really attract investment, governments should spend more on education and infrastructure, rather than collect less revenue by providing fiscal incentives.

Other groups looked at some of the equity implications of different types of tax expenditures. In Mexico, for example, the government itself publishes data on the distribution of benefits from different types of personal income tax deductions, by income decile. Table 3 below, where data has been taken straight from the government's tax expenditure report (Presupuesto de Gastos Fiscales, or PGF), provides a very interesting overview of the degree to which taxpayers in the top decile of income distribution benefit disproportionately from these deductions. For some types of deductions, like donations, school transportation or health insurance premiums, they grab more than 90 percent of the benefits provided. Similar findings – although with smaller differences between top and bottom deciles – are reported for VAT exemptions on health and education services.

TABLE 3. DISTRIBUTION OF PERSONAL INCOME TAX DEDUCTIONS BY INCOME DECILE IN FISCAL YEAR 2014

Decile	Donations	Voluntary pensions contributions	Special savings accounts	Mandatory school transport	Medical expenses insurance premiums	Medical, dental and hospital expenses	Tuition fees	Real interest on mortgage loans	Funeral expenses
I	0.1%	0.0%	0.0%	0.2%	0.1%	0.1%	0.1%	0.1%	0.2%
II	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.0%	0.1%
III	0.0%	0.0%	0.0%	0.1%	0.1%	0.1%	0.1%	0.1%	0.2%
IV	0.0%	0.0%	0.0%	0.1%	0.1%	0.1%	0.1%	0.1%	0.1%
V	0.0%	0.0%	0.0%	0.1%	0.2%	0.2%	0.2%	0.4%	0.3%
VI	0.1%	0.1%	0.1%	0.2%	0.2%	0.4%	0.4%	0.6%	0.7%
VII	0.2%	0.9%	0.5%	0.4%	1.5%	1.0%	1.0%	3.2%	1.8%
VIII	0.6%	3.3%	4.5%	1.0%	1.1%	2.6%	2.5%	7.4%	5.7%
IX	1.6%	11.1%	27.1%	2.9%	3.9%	7.5%	8.1%	22.8%	14.5%
X	97.4%	84.5%	67.7%	95.1%	92.8%	88.1%	87.5%	65.3%	76.6%
Total	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%	100.0%

Source: Secretaría de Hacienda y Crédito Público, *Presupuesto de Gastos Fiscales 2016*

[7] See, for example, World Bank/MIGA (2002) and World Bank (2018).

Still in Mexico, a group working in the state of Sonora compared the large benefits that companies active in the agriculture sector receive in a specific municipality against the huge problems of poverty and service delivery in the same municipality. This highlights the contradiction inherent in the fact that the same government that doles out incentives to large agribusiness claims not to have sufficient resources to provide basic services to poor people.

In Argentina, the group singled out a series of tax exemptions that are difficult to justify from a human rights or equity perspective, and constitute a significant cost to the public purse, with no real justification. These include different kinds of tax exemptions such as: (a) for sports clubs and sports activities of different sorts, including for football clubs who build or renovate stadiums, and for amateur sporting events; (b) on sales of newspapers and magazines; and (c) for religious institutions. They compare the costs of these tax expenditures, as reported by the government, with items of spending which receive very limited funding but could in principle be much more justifiable, like the budget for the National Women's Council, an important institution for defending women's human rights, or the budget for mental health. This gives a very direct sense of what the amount of foregone revenue could have helped finance, with some staggering figures.

The group also looked at another controversial measure introduced in Argentina in 1996 to exempt national and provincial judges, and other similar positions in the judiciary, from paying personal income tax. This provision has been interpreted very vaguely and expansively, despite its clear violation of both horizontal and vertical equity principles. A final example of seemingly unjustified benefits is the exemption of financial gains from the calculation of personal income. This includes interest accrued on a broad range of financial instruments, which are much more likely to be held by higher-income taxpayers, and amount to 60 percent of personal income tax-related tax expenditures, or around 0.4 percent of GDP. Again, it is not clear what the policy objective or expected impact of such benefits was meant to be – maybe encouraging more investment in certain areas – but the very unequal distribution of benefits is quite obvious.

Another interesting example comes from an analysis carried out in Brazil of the impact of certain categories of tax expenditures, related to constitutional provisions on the financing of basic services at subnational level. Most basic services in Brazil are provided at state and municipal level, and the transfers that these subnational units receive from the central government is set by law as a share of revenue collected by the central government from income taxation and from taxes on industrialized products (*Imposto sobre Produtos Industrializados*, or IPI). Based on increases in tax expenditures that affect these revenue sources between 2010 and 2014, the study estimated an increase in the revenue loss for states and municipalities over the same period of more than 17 percent. In other words, tax expenditure decisions taken at a central level are directly affecting the capacity of subnational governments to finance basic services.

The various examples presented here show how, even in the absence of detailed information and without using sophisticated techniques, it is possible to analyze tax expenditures in terms of their justification, objectives and expected impact, and to use available evidence to question how effectively they are being used by governments as fiscal policy instruments, whether they are in fact contributing to the objectives that in principle they are meant to pursue, and what their impact is on income distribution and service delivery.

LOOKING AHEAD: CHALLENGES AND OPPORTUNITIES

The analysis provided above, based on country research carried out by civil society groups across Latin America, provides an interesting snapshot of the extent to which different kinds of information on tax expenditures are publicly available, of the lack of openness in related decision-making processes, and on some aspects of the impact that different categories of tax expenditures have had on their stated objectives, whether related to investment and growth or to inequality. In this final section, some common challenges and opportunities are identified that could provide the basis for further analysis and advocacy going forward, again focusing on the three inter-related areas of transparency, decision-making processes and impact.

On ***transparency***, the research has shown that in all of the countries covered governments publish at least some information on tax expenditures, which is also helpfully collated and compared by CIAT. However, the level and detail of such reporting, and its compliance with existing international guidelines, varies greatly. For some countries, only the most basic information is made public on what types of tax expenditures exist and how much they cost in terms of foregone revenues. In other countries like Mexico, the information provided is more detailed, but it still falls short of legal requirements. Moreover, some specific and useful aspects of disclosure, like information on individual beneficiaries of tax expenditures or the use of open data formats, are still underdeveloped, if not totally absent. More generally, very few governments published the kinds of detailed data and information that are necessary to properly assess the effectiveness of tax expenditures and evaluate their impact, including on inequality.

To help highlight where the key gaps lie and provide the basis for improved regional assessment and advocacy, IBP intends to complement the work already completed by the project and carry out a more structured and comprehensive comparison of country practices on tax expenditure transparency, based on existing international guidelines. Some interesting recent initiatives could provide the basis for this exercise. In collaboration with Christian Aid, ICEFI is using a “Tax Incentives Scorecard” to look at different aspects of tax incentives in Central America, including information on their rationale and design, cost, efficiency, transparency, and a series of “red card” issues like negative impacts on women’s rights, labor rights or the environment. This provides a useful template for looking at the extent to which governments disclose the information that is necessary to guarantee proper accountability around tax incentives. Additionally, a recent paper for the G20 (IMF et al. 2015), again on tax incentives for investment, presents "Ten Principles to Promote Better Management and Administration" of tax incentives, and includes a benchmarking exercise which outlines relevant aspects not just of transparency around tax incentives, but also of the regular review of their effectiveness. Similar efforts could provide an overview for other types of tax expenditures beyond investment incentives, coming up with a more comprehensive methodology for assessing all relevant aspects of disclosure on tax expenditures that civil society groups could assess on a comparative basis.

The issue of tax secrecy and its impact on civil society's capacity to effectively monitor how the benefits of tax expenditures are distributed is yet another aspect of transparency that a number of groups have encountered and are planning to address. Across Latin America, tax secrecy and confidentiality are used as a justification for not publishing most kinds of tax data, even in cases where this should not be the case. Data can be published respecting the confidentiality of personal information of individual taxpayers, for example. On the other hand, information on business corporations benefitting from tax breaks can and should be made public, as would normally be the case for the beneficiaries of direct subsidies. IBP and a few project partners are planning a comparative study on tax secrecy practices across countries, to inform and support advocacy efforts aimed at reducing tax secrecy in their countries.

Dealing with opaque ***decision-making processes*** might be the most difficult, yet probably the most important challenge that civil society groups face. Tax expenditures are often provided as "favors" by governments to specific clients or lobbies, rather than driven by clear and transparent policy objectives, in deals that are negotiated behind closed doors with no proper scrutiny or evaluation. The scarcity of publicly available ex-ante evaluations of tax expenditure proposals across the countries covered in this study supports this perception. The few actors who receive most of the benefits from such deals, including governments themselves, of course have no interest in making sure that such processes are opened up and rendered more transparent and accountable. On the other hand, the losses to the public purse are collective and often indirect or invisible, despite their significance. This means that changing the *status quo* and promoting tax expenditure reform requires strategically thinking about the possible coalitions of actors who might mobilize against ineffective, arbitrary and costly tax expenditures, and promote a more transparent and policy-driven approach.

A recent briefing published by the Confederation of British Business (CBI) and three international development NGOs (Action Aid, Christian Aid and Oxfam) shows how such an alignment could be possible,[8] mobilizing the business community and civil society actors as part of a joint effort to promote a level-playing field in which all

[8] See https://policy-practice.oxfam.org.uk/publications/tax-incentives-in-the-global-south-620468

competitors are treated equally. Moreover, they could work together to ensure that all tax expenditures are based on basic principles of fairness. At the end of the day:

> *whether a particular tax preference or loophole or exemption is unfair should be determined by whether it undermines the capacity of the system to promote the broader aims of justice in the society, however they are interpreted.* (Murphy and Nagel 2002: 172)

This effort would inevitably entail assessing the distributional impact of tax expenditures, and their impact on a government's responsibility to fulfil its human rights obligations. Moreover, decisions around tax expenditures should be underpinned by a transparent and clear legal process with democratic oversight and political scrutiny, consistent with national economic policy and regularly reviewed and assessed, so that everyone can benefit. Other similar coalitions could probably be imagined and created bringing together social movements and progressive politicians and officials.

Thinking about the shape that alternative and improved decision-making processes could take is also important. The authors of the paper on Colombia present some interesting ideas on this, arguing that what is needed is the creation of an "argumentative space" where adequate justifications for the introduction or renewal of tax expenditures are provided and can be debated and deliberated on.[9] They propose three criteria for public justification of tax expenditures:

1. Is the proposed tax expenditure an effective means to reach government objectives?
2. Is the proposed tax expenditure strictly necessary and better than any existing alternatives?

Does the proposed tax expenditure have benefits that outweigh costs in terms of transparency, inequality, efficiency, etc.?

In their words, "what is important is finding a vocabulary that can facilitate constructive conversations around the abusive nature of different tax benefits".

Civil society can no doubt play an important role in the development of such a common language. But it could also push – again as suggested by the Colombian group – for discussions on tax expenditures to be brought into the regular budget process, making them subject to the same procedures followed for annual revenue and spending decisions. This could provide for a more automatic and regular review of the objectives and effectiveness of tax

[9] A somewhat similar proposal has been put forward by Rodrik (2004) in the context of industrial policy, who suggested the creation of so-called Coordination and Deliberation Councils, public-private bodies that would promote an open and transparent process for deciding on government support for industry, including through tax expenditures.

expenditures, and could allow for a transformation of the budget process itself into the "argumentative space" referred to above, but encompassing all tax and spending policies rather than just tax expenditures.[10]

While these various forward-looking options and objectives can form the basis of longer-term advocacy and coalition-building activities, it is still important for civil society groups to come to a better understanding of how decision-making processes around tax expenditures have actually worked in the past – or are working in the present. Where and when are the key decisions taken? Who are the key actors and networks that are able to exert influence on such decisions, and what are their interests and motivations? Are key decisions taken based on formal or informal processes? What is the legal framework for tax expenditures, and to what extent is it followed in de facto practices? What mechanisms exist for citizens to access information and exert some influence on decision-making processes related to tax expenditures? These are some of the questions that civil society groups should try to grapple with in their efforts to better understand how decision-making processes around tax expenditures work in practice, and to find ways to influence them in some way.[11]

Finally, the key challenges on ***impact*** relate to the dearth of evaluation studies produced and published by governments, to the lack of adequate data and information available to independently assess the effectiveness of tax expenditures in achieving their stated objectives, and the methodological complexities of cost-benefit analyses and micro-simulation models often used in these evaluation exercises. A quick search for available materials and guidelines on tax expenditure evaluations reveals that there is a lot out there for various actors to use as a guide on how to assess the impact of tax expenditures. For example:

1. The US Government Accountability Office (GAO) published a very useful guide with detailed criteria and questions that can guide tax expenditure evaluations; numerous examples of their work in this area are included (GAO, 2013).
2. The Irish Department of Finance published a paper with guidelines on how to carry out both *ex ante* and *ex post* evaluations of tax expenditures (DOF, 2014).
3. The United Nations worked with CIAT to produce a guide on designing and assessing tax incentives in developing countries, which outlines a framework for carrying out cost-benefit analyses and provides an example on tax incentives for the tourism industry in the Dominican Republic (UN/CIAT, 2018).
4. A similar report was prepared by the IMF and others for the G20, presenting different tools that can be used for the assessment of tax incentives by governments in low-income countries (IMF et al. 2015).

[10] This idea is also promoted by others, such as Brixi (2004).

[11] Political Economy Analysis provides some interesting tools and approaches to think about these questions. For a review of existing practices, see Mcloughlin (2014).

5. The OECD's 2010 review of tax expenditures in its member countries includes an analysis of review procedures that various governments have put in place to ensure that tax expenditure evaluations are carried out and acted upon (OECD, 2010).
6. As part of the LATERAL project, IBP has produced a short guide for civil society researchers, highlighting key issues and resources for evaluating tax expenditures (Ross, 2018b).

As already highlighted, most governments in the countries covered by the LATERAL project either do not produce or do not publish evaluation studies on tax expenditures, and often do not provide public access to data that would allow for such studies to be carried out independently. This is by no means a situation that characterizes Latin America more than other regions. A recent article in Le Monde highlighted a similar situation in France, where the tax expenditure report for 2016 issued by the *Cour des Comptes* – France's Supreme Audit Institution – found that:

> *"[…] there are 451 tax expenditures, 179 of which have been in place for more than 20 years without being evaluated. Among them, 37 measures – accounting for 2 billion EUR – have not been modified since their creation. Moreover, 107 are defined as 'impossible to be quantified', hence representing an unknown cost for public finances."*[12]

Even if governments did provide sufficient data, many civil society groups would probably find it very difficult to carry out some of the sophisticated analyses needed for a full assessment of the effectiveness of tax expenditures in achieving their stated objectives, such as increased investment and growth, or making taxation more progressive to reduce inequality. As a consequence, the first objective and strategy for civil society groups should probably be to push governments to put in place processes and procedures for the regular review and evaluation of tax expenditures.

Yet, as this project has shown, there are ways for civil society groups to engage in debates on tax expenditures, and not just by pushing governments to evaluate the impact of tax expenditure provisions or publish the data necessary to do so. For example, groups can question decisions on tax expenditures by (a) analyzing their stated policy objective, and assessing the adequacy and relevance of those objectives against available evidence or against principles of fairness, justice and human rights; (b) looking at more general evidence on the objectives that tax expenditures are supposed to achieve and the economic or social indicators that best capture them; and (c) showing the trade-offs between the costs of tax expenditures and spending on priority items that cannot happen because of the lack of revenue that the tax expenditure generated. They can also see if they are designed in a way

[12] See '*En France, l'efficacité de la dépense fiscale reste difficile à évaluer*' (Le Monde, 23 October 2017). The English translation was taken from https://www.cepweb.org/in-france-evaluating-tax-expenditure-effectiveness-remains-a-challenge/.

that is more or less likely to elicit compliance or abuse, to benefit those that are supposed to benefit, and/or whether those benefits are likely to generate significant distortions.

These approaches may not be sufficiently rigorous to provide conclusive evidence, and may not manage to address the specifics of an individual tax expenditure provision, focusing on broader categories with similar objectives instead. At the same time, expanding and deepening these and other simpler approaches, and applying them to different types of tax expenditures can contribute to a broader debate on their adequacy and impact as fiscal policy tools, and possibly push governments to produce and publish their own evaluations in response, broadening the information available and bringing about more transparency and accountability.

CONCLUSIONS

This paper brought together findings from a collaborative regional project involving civil society groups across nine Latin American countries looking at different aspects of tax expenditures. The project was motivated by the recognition that governments across the region, despite adopting language and policies promoting fiscal austerity and spending reductions, do not collect a significant percentage of the revenues they are owed due to different types of tax reductions and exemptions. These lost resources could have been used to deliver basic services, reduce poverty and realize human rights. Their significance – often amounting to several percentage points of a country's GDP – and their impact therefore deserve closer scrutiny and debate.

The analysis carried out by the groups focused on levels of transparency, on the nature of decision-making processes and on evidence of impact and effectiveness. The picture that emerges is a pretty discouraging one, where public information is often inadequate, decision-making processes are closed and prone to abuse and corruption, and impact, in the few instances where it is measured, is often negative or unsatisfactory, contributing to inefficiencies and to inequality. While groups involved in the project were hoping to focus on the impact that tax expenditures have on poverty, inequality and human rights, they found that this is rendered very difficult by the lack of adequate information, and by the fact that governments do not carry out regular reviews of tax expenditures, and do not produce and publish evaluations of their impact. Such dearth of publicly available information, and the closed nature of decision-making processes around tax expenditures, creates opportunities for the use of tax expenditures for political purposes, generating benefits for a few powerful groups and costs for the rest of society.

While civil society groups face important challenges in monitoring and evaluating tax expenditures, and in influencing decision-making processes around them, this paper points to ways in which this incipient agenda can be expanded and built upon, contributing to the opening up of a serious conversation and better informed debate on how tax expenditures are used by governments in the region, and how their impact can be improved.

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