Tax Policy for Inclusive Growth in LAC

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Key messages

- Taxes in LAC could be ***simplified*** and ***redesigned*** to raise revenue in a growth-friendly and inclusive way—focus mostly on ***direct taxes***:
  - ***PIT***: address design flaws and deductions while introducing an EITC
    - help raise revenue, improve equity and potentially boost growth
  - ***CIT***: align rates and broaden base
    - help attract investment, foster growth and limit base erosion
- Within ***indirect taxes***, room to improve ***VAT*** in some countries
    - include targeted transfers to compensate vulnerable households as needed
- Other untapped revenue sources can be fostered (**property, environmental taxes**)

Average tax collection in LAC is low relative to the OECD, and its tax structure is very different…

Despite improvements over 2005-19, LAC collects significantly less tax revenue than the OECD…

…and while VAT is the main revenue source, LAC collects much less (more) than the OECD in PIT (CIT)

Fig 1. Tax revenue collection 2005-19: LAC and OECD
(percent of GDP)

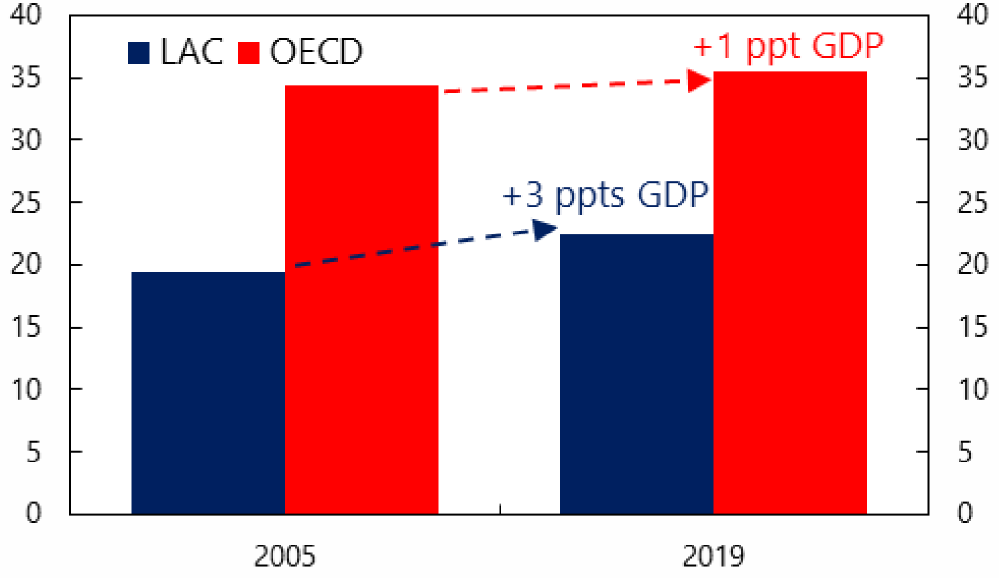


Table 1. Tax revenue collection in 2019: LAC and OECD
(percent of GDP)

	LAC	OECD
Value added taxes	6.3	7.2
Personal income taxes	2.3	8.8
Corporate income taxes	3.7	2.8
SSCs and payroll taxes	4.0	10.2
Other taxes	6.1	7.0
Total tax revenue	22.4	35.5

Source: IMF staff calculations based on OECD Tax Revenue Statistics database.

...even when adjusting for development levels, and with different growth effects

The chapter explores how to raise tax revenue in a growth-friendly and inclusive way, internalizing LAC's structural characteristics / constraints

Fig 2. Taxation and development: CIT

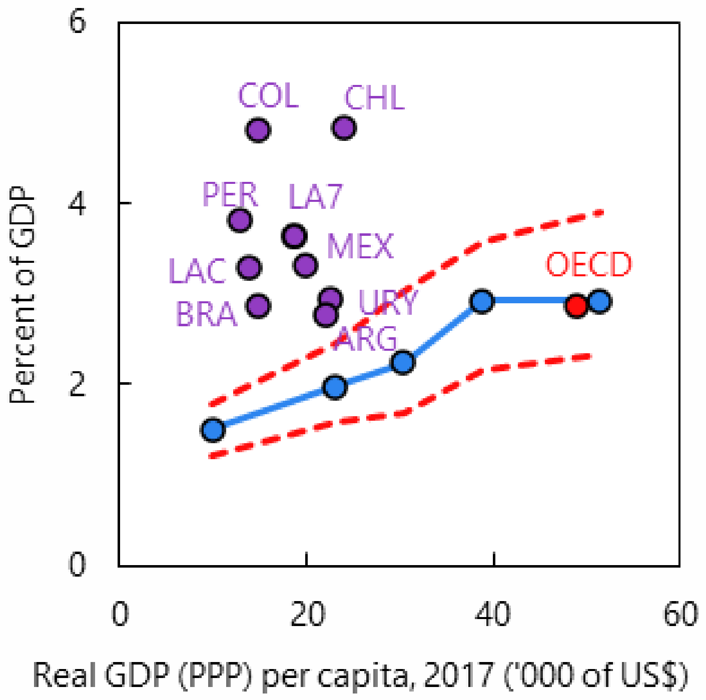


Fig 3. Taxation and development: PIT

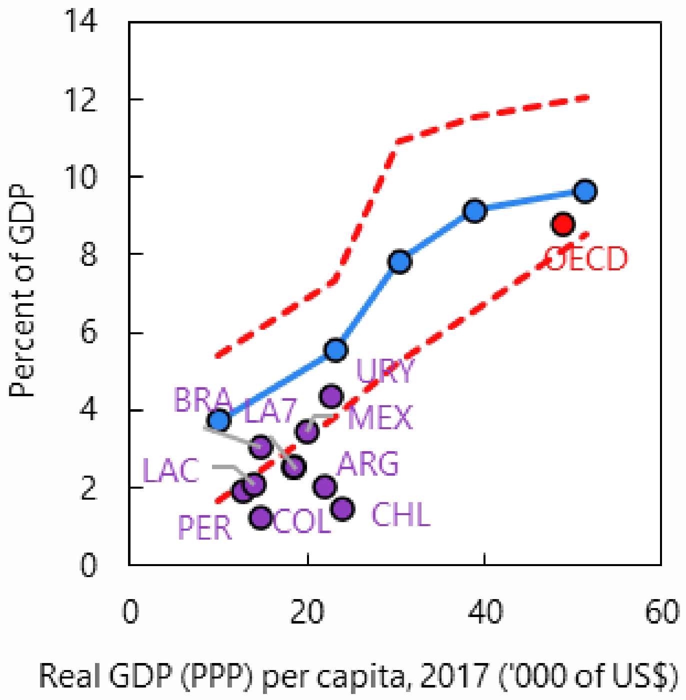
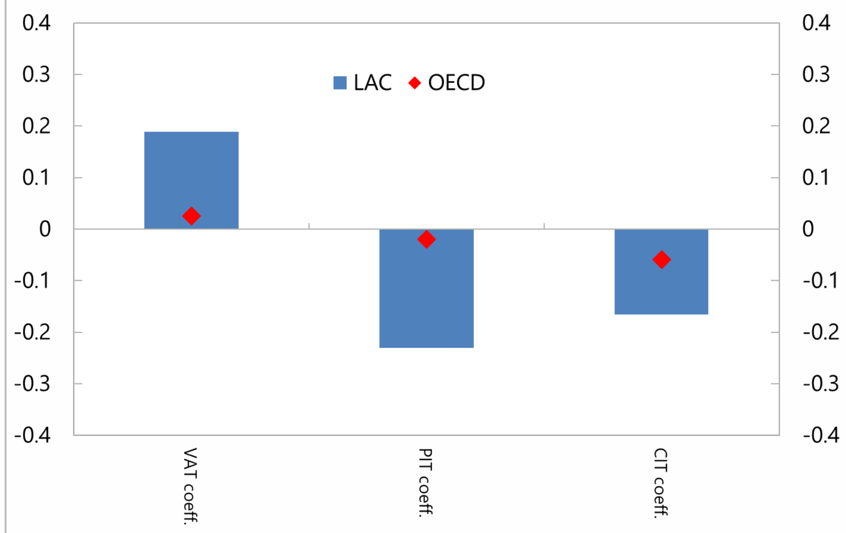


Fig 4. Taxation and growth: VAT, PIT and CIT
(long-run coefficients; point estimates)



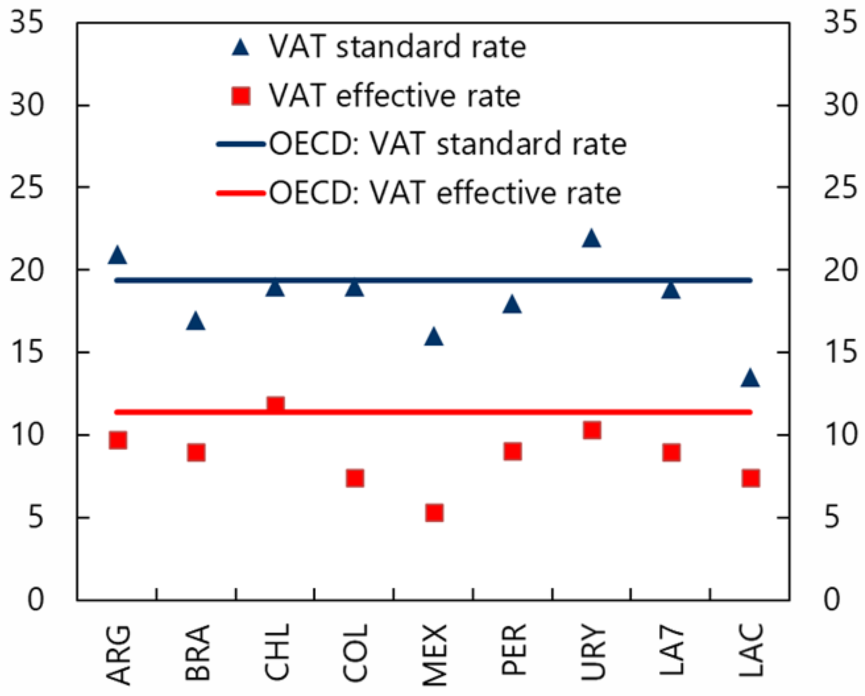
Note: Markers: Median value for each quintile (OECD sample); dotted lines:75th and 25th percentiles (OECD distribution); country codes / groups: 2019 values.
Source: IMF staff calculations based on Acosta-Ormaechea et al. (GER, 2019), and using OECD Tax Revenue Statistics database and WEO.

Source: Revenue-neutral regression analyses based on Acosta-Ormaechea and Morozumi (ITAX, 2021). Coefficients on LAC sample (16 countries, 1992-2019, 376 obs.) significant at 1 percent. Coefficients on OECD sample (33 countries, 1972-2019, 1112 obs.) only significant for CIT at 10 percent. Only countries with 15+ years of continuous tax/macro-fiscal data are used.

VAT *broadly* comparable to OECD, but not CIT: High rates and exemptions hamper competitiveness and erode base

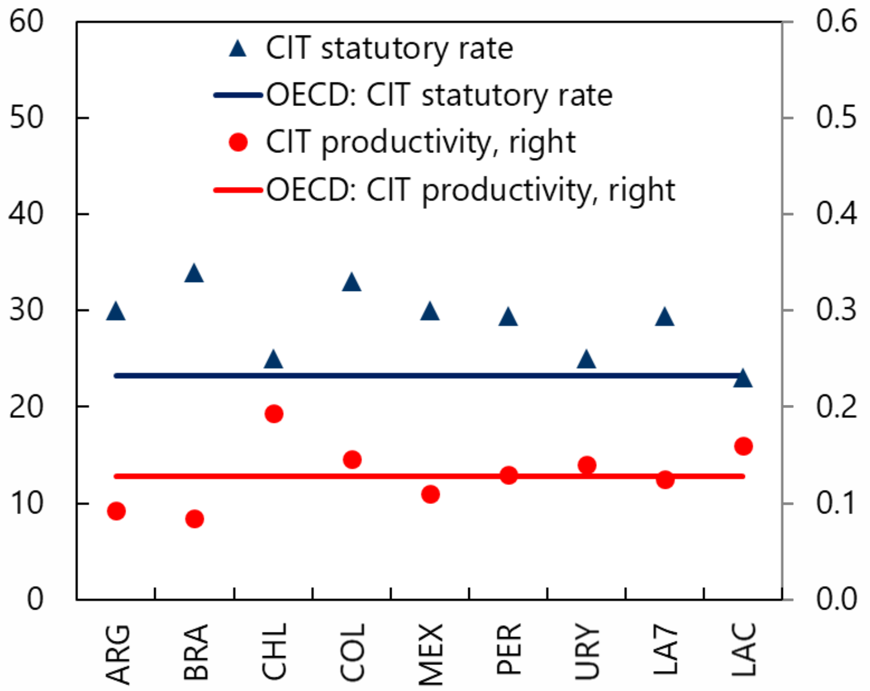
Despite relative high VAT collection, reduced rates, exemptions and informality erode the base…

Fig. 5. VAT features in LAC and OECD in 2019 1/
(percent of GDP)



High CIT rates in LA7 help with collection but affect competitiveness… exemptions lower CIT productivity, create distortions and add complexities

Fig. 6. CIT features in LAC and OECD in 2019 1/
(left axis percent; right axis percent of GDP)

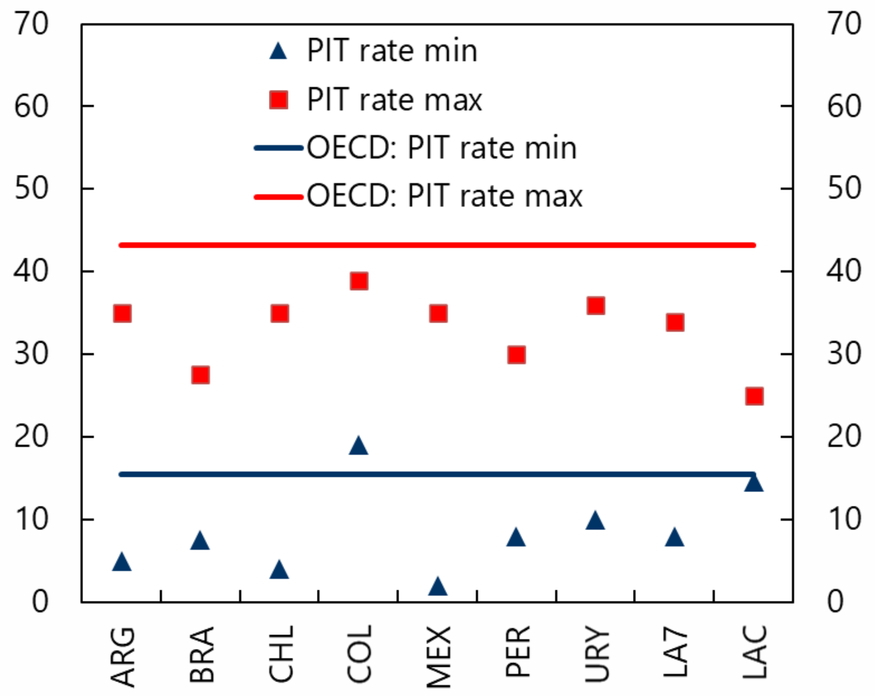


Note: 1/ LAC average excludes LA7 countries.
Source: IMF staff calculations.

LAC's large PIT gaps reflect major design flaws

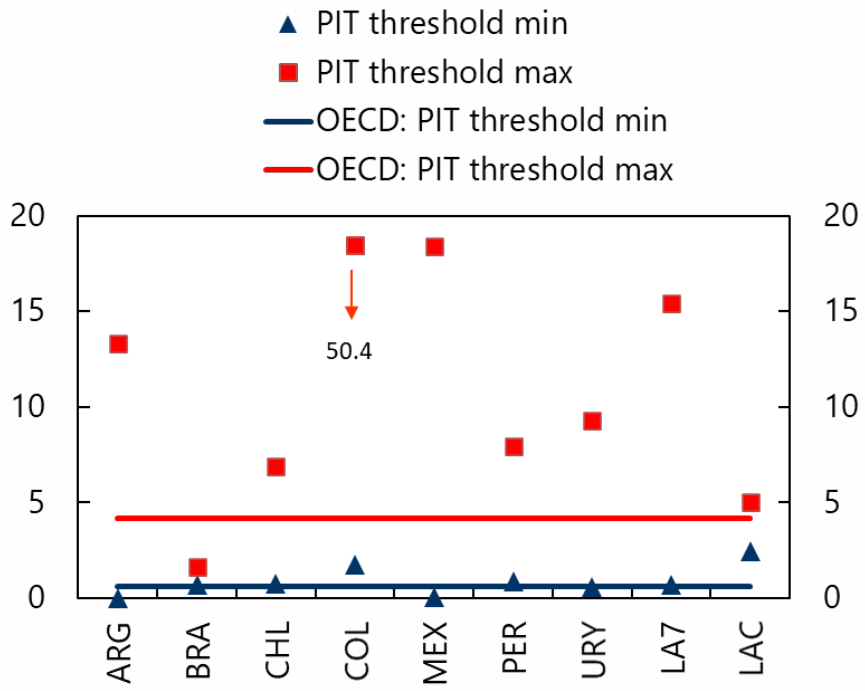
Raising PIT revenue would require increasing statutory rates…

Fig. 7. PIT statutory rates in LAC and OECD in 2019 1/
(percent)



…and revising thresholds (especially maximum)

Fig. 8. PIT thresholds in LAC and OECD in 2019 1/
(ratios relative to GDP p. c.)

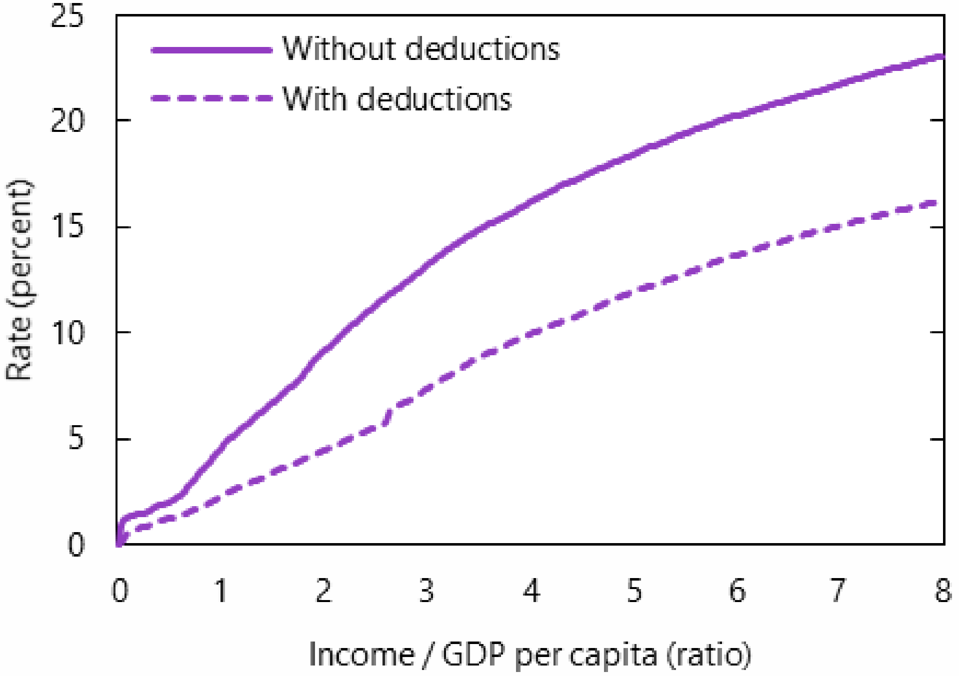


Note: 1/ LAC average excludes LA7 countries.
Source: IMF staff calculations.

Microsimulations show potential to *improve collection* (eliminating deductions) and *equity* (gender, EITC)

Deductions significantly reduce the effective PIT rate paid by high income workers/individuals

Fig. 9. Average PIT rates across income levels in LA5, 2019



Eliminating deductions simplifies system and raises revenue w/o taxing low- and middle-income workers

Table 2. Microsimulation of PIT reforms in LA5, 2019
(*percent*)

Scenario	Revenue change relative to baseline	Avg. PIT rate Top 10% of earners	Gini change relative to baseline
Baseline	…	9.2	…
No deductions	137	14.3	-1.6
No deductions + EITC	106	14.3	-3.6

Note: for effective rates w/ deductions computations are for a single worker with two children
Source: EY Worldwide Personal Tax and Immigration Guide (2019) and IMF staff calculations.

Concluding Remarks

- **Significant scope to redesign and simplify *direct taxes*** to raise revenue, foster progressivity and boost growth

- **Additional elements** need to be considered: Political economy; sequencing of reforms; tax administration capacity

- **REO chapter available at: https://www.imf.org/en/publications/reo**

- **Blog available at: https://www.imf.org/en/News/Articles/2021/12/10/na121021-Taxes-Support-Growth-Reduce-Inequality-Latin-America-Caribbean**

- **Working Paper available at: https://www.imf.org/en/Publications/WP/Issues/2022/01/21/Tax-Policy-for-Inclusive-Growth-in-Latin-America-and-the-Caribbean-511829**