LATIN AMERICA ADVISOR

A DAILY PUBLICATION OF THE DIALOGUE

www.thedialogue.org

Monday, July 27, 2020

FEATURED Q&A

What Tax Reforms Does Latin America Need for Recovery?

Falling tax revenues and tax evasion are expected to pose challenges to Latin America's economic recovery from the Covid-19 pandemic. Brazil's tax agency is pictured above. // File Photo: Agência Brasil.

Q Countries in Latin America and the Caribbean face a steep drop in tax revenue due to the slowdown of economic activity amid the pandemic and lower prices for commodities, the Economic Commission for Latin America and the Caribbean, or ECLAC, said in a report this month. In addition, tax evasion continues to be a problem for the region, with ECLAC estimating a loss of $325 billion—more than 6 percent of GDP—due to tax noncompliance even before the recession. How important, and controversial, will tax policy become as Latin American and Caribbean countries seek to reactivate their economies in the period ahead? What would the ideal tax policy look like, and which sectors, if any, should see tax breaks during the post-pandemic recovery? How big of a problem is tax evasion in the region, and what can governments do to ensure taxpayers, especially companies, comply?

A Manuel Baltazar Mancilla, chief executive of México Fiscal: "It will be of utmost importance to define an adequate tax policy, aimed at strengthening the basic input and industrial sectors, since the service sector can wait a bit. Public policies might become very controversial, especially in those countries whose governments are betting on social welfare at a time when support is required for entrepreneurs. It is necessary to boost GDP and improve the population's purchasing power, which can only be achieved by promoting employment. Tax evasion occurs to a greater extent with property taxes, so perhaps it is time to bet on consumption taxes. If we want to support citizens, we must exempt or reduce the burden on direct property

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El Salvador Arrests Former Defense Minister Over Gang Pact

Salvadoran authorities arrested former Defense Minister David Munguía Payés in connection with a 2012 pact between the government and the country's main gangs.

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Workers at Chile's Zaldivar Mine Accept Wage Offer

Workers at Antofagasta's Zaldivar mine have accepted a wage offer, averting a strike. Collective bargaining talks had earlier broken down.

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Chile's Piñera Signs Pension Withdrawal Bill

Chilean President Sebastián Piñera signed into law a measure that will allow citizens to withdraw a portion of their pension funds as an emergency measure amid the coronavirus pandemic.

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Piñera // File Photo: Chilean Government.

POLITICAL NEWS

El Salvador Arrests Former Defense Chief Over Gang Pact

Authorities in El Salvador have arrested former Defense Minister David Munguía Payés in connection with a pact involving the country's main gangs in 2012, the Associated Press reported Friday. Munguía was arrested for his alleged involvement in relation to the pact that was formed during the administration of then-President Mauricio Funes, said the country's current attorney general, Raúl Melara. The government struck the deal with the Mara Salvatrucha and Barrio 18 gangs in an effort to lower El Salvador's murder rate. In exchange, authorities moved some imprisoned gang leaders from high-security to medium-security prisons, from which they were able to continue managing the gangs' activities, the AP reported. Melara said investigators determined that Funes and Munguía devised the pact, adding that El Salvador's attorney general's office is also pursuing Funes, who fled to Nicaragua and was granted asylum in 2016. In a posting on Twitter, Funes denied involvement in the pact. "I never met with gangsters, nor did I order any official to do so," he said in the posting. "I never ordered nor authorized prison privileges for any gang member." Munguía's attorney, Manuel Chacón, said last Thursday that he had not been informed of the charges against the former defense minister, adding that the he and Munguía had long known about the investigation into the gang pact because prosecutors had Munguía testify several times about it. In another case related to the gang pact, Munguía said the agreement was a public policy that originated from Funes' cabinet. "My role was to facilitate the work of the mediators and receive reports from the mediators and members of the [Organization of American States] and keep the president of the republic informed of advances in the process," Munguía said at the time. Chacón told the AP that he would ask a judge to allow Munguía to remain out of jail as he awaits trial because he is older than 70 and has enough family ties in El Salvador to prevent him from fleeing the country. While the pact was in force, El Salvador's homicide rate fell from about 14 killings per day to five. However, the agreement fell apart in 2013 after the country's Supreme Court removed Munguía from his position as defense minister and authorities ended privileges that they were providing imprisoned gang leaders. The country's homicide rate then increased again, the AP reported.

Former President Mauricio Funes denied involvement in the pact.

Norway Envoys Expected to Arrive in Venezuela

Venezuela's political opposition said Friday that it was expecting the arrival of government representatives from Norway in the Andean nation, Reuters reported. In a statement, the opposition said Norway had informed it that its representatives would observe the South American country's "political and humanitarian situation." The visit comes almost a year after the end of talks in Oslo between Venezuela's divided government and opposition, which Norway's foreign ministry mediated. The opposition declared those efforts dead last September, saying that President Nicolás Maduro was not willing to seriously negotiate for a new election. In the Friday statement, the opposition highlighted that there is no

Maduro // File Photo: Venezuelan Government.

NEWS BRIEFS

Guyana's Court of Appeal to Issue Final Ruling Thursday on Election

Guyana's Court of Appeal said Saturday that it will provide a final ruling regarding ongoing challenges with the disputed March 2 regional and general elections on Thursday, the Jamaica Gleaner reported. The case is in connection with the Guyana Elections Commission's move to make a declaration of the March 2 elections, using votes by the national recount process, which the challenger alleges was ruled unconstitutionally by the Caribbean Court of Justice, or CCJ, on July 8. Both the elections commission and the CCJ declared a win for the opposition.

Hundreds of Nicaraguans Stuck at Costa Rican Border Over Virus Fears

Hundreds of Nicaraguans are stuck at the border of Costa Rica and Nicaragua after their homeland refused to allow them back in without proof that they are not infected with the novel coronavirus, Costa Rica's immigration department said on Friday, Reuters reported. About 300 Nicaraguans are stranded, having been barred from entering. During the pandemic, about 18,000 Nicaraguans have been turned away from Costa Rica, which on Saturday registered its highest daily Covid-19 toll, with 931 new cases and 11 deaths.

Workers at Antofagasta's Zaldivar Mine in Chile Accept Wage Offer

Workers at the Zaldivar copper mine in Chile, which is owned by Antofagasta, have accepted a revised wage offer, averting a strike, Bloomberg News reported Saturday. Members of the union representing workers at the mine voted 387-236 for the offer, the news service reported. Talks had previously broken down during collective bargaining.

negotiation process going on right now. "There is not any dialogue process underway at this moment, and we reiterated to the Norwegian delegation that only free and fair elections can solve this crisis," the statement said, Reuters reported. Neither Norway's foreign ministry nor Venezuela's information ministry immediately responded to Reuters' requests for comment. The announcement came as lawyers for Venezuela's central bank, or BCV, said they had won the right to appeal a ruling by the English High Court that recognized Venezuelan opposition leader Juan Guaidó as the country's president. The decision had effectively denied the Maduro government access to nearly $1 billion worth of gold stored in the Bank of England.

ECONOMIC NEWS

Chile's Piñera Approves Pension Withdrawal Measure

Chilean President Sebastián Piñera on Friday signed into law a measure to allow citizens to withdraw as much as 10 percent of their pensions savings, as people lined up at the administrator's office in Santiago to take advantage of the economic relief, Reuters reported. The president's office said Piñera had signed the bill late on Friday but made no comment on its content. The government had staunchly opposed the legislation while it was being discussed in both houses of Congress, even announcing it would help support citizens with public money instead. It also warned of long-term consequences on the profitability and already low average payouts of pensions. In a statement last week, Piñera's office said it would sign the plan into law in response to the widespread support given the country's "difficult economic and social situation," CNN en Español reported. Lines formed on Friday outside offices of pension fund administrators, with polls showing that nearly nine out of every 10 Chileans planned to dip into their pension funds. Economists say that Chile's struggling economy could get a short-term boost, with a total estimated $16.65 billion potentially to be used for consumption, according to think tank Ciedess, Reuters reported. However, they also warned of the negative impact on pension funds, which hold more than $200 billion in assets and which may liquidate local stocks and bond holdings to pay out savers.

Piñera's government had staunchly opposed the measure.

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taxes and leave the burden of collection on taxes imposed on consumption, even imposing higher taxes on luxury goods. The more money we leave in citizens' pockets, the more the economy grows, and so also grow tax revenues. Such a measure must go hand in hand with the promotion of the domestic market in each country. It will be key to implement fiscal stimuli with rules that guarantee economic improvement in each locality, with a strict vigilance of tax payments, a situation that can be resolved through electronic control of trade. We need to bet on business investment, coupled with a commitment to job creation and improvement, in order to get back tax contributions that improve everyone's economy as a whole."

A María Fernanda Valdés, author and coordinator of tax issues for the Friedrich Ebert Stiftung in Colombia and Latin America: "The inevitable reality is that restoring economic growth in Latin America will have a significant financial cost, and time will soon come for tax reforms, as has happened during all economic crises in the region, and probably elsewhere. In fact, preliminary discussions about tax reforms are already on the agenda in many Latin American countries. Now, how should a new wave of tax reforms in the aftermath of this crisis look? A good start is to work on compliance measures. Evasion and avoidance are in fact important fiscal challenges, with evasion alone costing around 6.3 percent of regional GDP. Yet, the root of evasion and avoidance has a predominant international component, and with base erosion and profit shifting (BEPS) negotiations falling apart after the United States decided to step back, I do not see much happening on the international front, and plain national measures will fall short. Ideal tax reforms must go beyond compliance measures and focus, first, on increasing tax revenues. The danger is that businesses have started to push for tax breaks and other expensive incentives in Latin America, a region already rife with tax benefits and with dubious results at best in terms of economic stimuli. Countries should instead focus on equity. In one of the most unequal regions of this planet, the poor, those who are excluded and women are already paying the biggest price in this crisis, and they must not be left to carry the economic burden of recovery as well. New revenue should not come from workers or poor customers in the form of a value-added tax or other regressive taxes. Instead, they should come from those economic sectors that are thriving during the pandemic and from the richest segments of the society, which are paying very low taxes in Latin America (the top decile in Latin America pays an exceptionally low effective tax rate of less than 5 percent; in comparison, in the United States, this rate is 14.2 percent). This is also the least distortionary and a growth-friendly way to collect—thus a win-win policy response to the crisis."

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"The inevitable reality is that restoring economic growth in Latin America will have a significant financial cost..."

— María Fernanda Valdés

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Gabriela Rosa Lopes, tax and legal consultant at BMJ Consultores Associados in Brazil: "Several Latin American countries have already understood that economic recovery must come with tax measures with two guidelines: tax simplification and transparency. Tax payments have to be a simple task not only to facilitate tax collection and reduce the incidence of mistakes in tax compliance, but also to facilitate inspection. In Brazil, the tax reforms in discussion intend to unify consumption taxes so that, in the future, it is possible to reduce the burden on this economic base and raise the taxation on income and profits. The mere simplification will already reduce company expenses with numerous tax teams, advisory services and legal liabilities. In this sense, the ideal reform is one that decreases the time spent paying taxes and does not require further adjustments in a few years, so that the next step is to reduce the tax burden. Globally, the economy gains and reduces market costs. The problem of tax evasion will be urgent following the pandemic. Countries such as Peru and Colombia are talking about changing their legislation on the sale of goods between related companies abroad (transfer pricing). The Special Department of Federal Revenue of Brazil has been developing changes in the way it accesses taxpayers in debt, through negotiations to recover large debts. The focus of these countries should not be on raising the tax burden. The collection problem that they face today is not due to a low burden, but rather to the fact that the systems in force are not efficient, as they are not as modern as the changes that the economy demands."

> **"The problem of tax evasion will be urgent following the pandemic."**
>
> **— Gabriela Rosa Lopes**

Carlos Wong Z., president of the Free Zones Association of Costa Rica: "Covid-19 has affected Costa Rica, leading to a significant impact on its macroeconomic variables in 2020: a contraction in GDP of between 4 and 4.9 percent and unemployment of between 16 and 17 percent. To these indexes, add a fiscal deficit of approximately 9 percent, driven by a drop in income of approximately 12 percent in the first half of the year. Faced with these challenges, the country has taken positive steps that could lead to a revival of its economic activity in the coming years. Some of these are part of joining the OECD, as well as its labor reforms and recent fiscal reform, including the framework of fiscal rules to promote balance in public balances. As for new measures, a recent evaluation by the OECD gives a clear outline for several of them. Among the most prominent is the simplification of regulations, the digitization of the state and the reduction of bureaucracy. In fiscal matters, the OECD recommends increasing the value-added tax rate, as well as a more open monetary policy that provides liquidity to the banking system. Regarding government, it recommends reviewing salary policies and the efficiency of public spending. Regarding employment, stimulating the development of public infrastructure is an urgent task for Costa Rica, as well as maintaining its successful FDI attraction program, particularly in the life sciences and value-added services sectors, which have proven to be highly resilient and dynamic amid the pandemic."

The Advisor welcomes comments on its Q&A section. Readers can write editor Gene Kuleta at **gkuleta@thedialogue.org**.

LATIN AMERICA ADVISOR
is published every business day by the Inter-American Dialogue, Copyright © 2020

Latin America Advisor is published every business day, except for major U.S. holidays, by the Inter-American Dialogue at
1155 15th Street NW, Suite 800
Washington, DC 20005

www.thedialogue.org

ISSN 2163-7962

Subscription inquiries are welcomed at
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