



Third Plenary Meeting

Valparaiso, Chile

April 1 to 3, 2004

Report of Working Group III: Fiscal Affairs

The Working Group on Fiscal Affairs held three meetings on April 1 and 2, 2004, and was chaired by Brazilian Congressman Luiz Carlos Hauly. A list of participants is presented in Annex 1.

1. Presentation by the Guest Speaker

The analysis of the topic “Tax Systems of the Americas” began with a presentation by Mr. Juan Cristobal Bonnefoy, Budget Policy Researcher at ECLAC’s Latin American and Caribbean Institute for Economic and Social Planning (ILPES), who spoke about tax harmonization and the main challenges.

Mr. Bonnefoy divided his presentation into three main points:

1. Current status of tax systems in Latin America and the Caribbean

There has been an increase in the tax burden in the region between 1990 and 2002, which resulted in a higher revenues, which helped bring deficits down to almost 1% of GDP. However, from 1997 to 2002, there was an increase in the deficit to about 3% of GDP.

2. Impact of globalization on tax systems

Although trade liberalization improves economic efficiency and speeds up development, it produces a loss in public revenues in countries with fiscal imbalances, which requires careful assessment.

Even though tax revenues from international trade and transactions average 10.7%, there are three countries where more than one fifth of revenues comes from those sources (Haiti, Dominican Republic and Nicaragua). In contrast, two countries have a tax dependency of about 1% (Brazil and Uruguay). Hence, there are two groups of countries, one with heavy dependency on these sources of revenue, which would justify the approval of structural funds to make the necessary compensations.

As a result, the countries have reacted by passing tax packages that have “polluted” the system and have led to regression in the global balance of fiscal accounts (half a decade lost). Furthermore, a regressive tax policy has been adopted, with the burden of taxation falling on consumption and labour.

3- Harmonization of tax systems

3.1. Arguments against:

- It works against the freedom of governments to make their own policies and against the freedom of individuals to choose where to work, save and invest. Therefore, it affects growth.
- It has a negative impact on the equitable distribution of income.

3.2. Arguments in favour:

- It allows taxation of transactions carried out via electronic means.
- It facilitates the taxation of sales by transnational between their head offices and branches.
- It discourages the transfer of resources to tax havens.

3.3. Avenues toward harmonization

Tax harmonization has not been included in the agenda of FTAA negotiations.

- Explicit harmonization: Countries commit to establish minimum or common rates.
- Implicit harmonization: Can be achieved through multilateral or bilateral agreements that facilitate the exchange of tax information or double taxation agreements.

Mr. Bonnefoy also referred to the fiscal pacts recommended by ECLAC, in which each country sets parameters as guidelines for the tax structure (case of Guatemala).

He considered that the following are relevant questions, although difficult to answer at the moment:

What convergence model should be used? The EU model, the American model or the Asian model?

What is the optimum level in terms of tax burden?

Mr. Bonnefoy referred to the case of loser countries that would merit tax compensation.

Last, he mentioned tax decentralization as a priority for tax harmonization.

2. Working Group discussion

The members of the Working Group participated extensively in the debate, with the following contributions standing out:

Congressman Luis Carlos Hauly (Brazil) maintained that no real effort to harmonize tax systems in Latin America is evident. In general, more stress has been placed on indirect taxes than on direct taxes, which has a strong regressive impact on lower-income individuals.

Congressman Carlos Kuschel (Chile) referred to the importance of harmonizing expenditures as well as revenues, since there are no real controls over the efficiency and effectiveness of spending.

Senator Marc Harb (Canada) affirmed that it is highly important to standardize systems, since it is a very complex task to establish bases for comparison at present.

Congresswoman Jeannette Madriz (Venezuela) considered it necessary to include the subject of tax harmonization in the discussion of trade agreements in the Americas.

Congressman Sergio Diaz (Colombia) acknowledged the importance of spending efficiency. At the same time, consideration should be given to creating a structural fund to leverage growth in countries with weaker economies. He proposed that thought be given to the efficiency and equity of the VAT.

Senator Juan Carlos Restrepo (Colombia) stressed the efficiency of spending and long-term planning to arrive at convergence among the Latin American countries.

Congressman Luiz Carlos Hauly (Brazil) proposed the creation of a technical body inside FIPA to make a permanent study of the simplification of tax systems. Simplification is directly related to the degree of taxpayer compliance, which would lead to higher revenues.

Mr. Juan Cristóbal Bonnefoy (ECLAC) clarified that a culture of compliance lies at the core of the system and must be supported by a strengthened and transparent Tax Administration.

Congressman Jesus Martinez (Mexico) pointed out that the complexity of tax systems discourages people from paying. On the other hand, globalization has revealed a mismatch in tax systems, and a diagnostic study is required for the creation of a political and social pact that will allow a methodical agenda to be prepared in a transparent atmosphere.

Congressman Carlos Hidalgo (Chile) mentioned that one of the problems is to oversee efficiency in spending, because even though the social projects may be well meant, political intervention distorts the original objective. In this framework, he highlighted the fact that a joint budget committee had recently been created as a permanent body, which will allow for adequate oversight of spending in Chile.

Mr. Juan Cristóbal Bonnefoy (ECLAC) stressed that increased spending is not enough to reduce poverty levels. He felt it was important to include the subject of monitoring public spending on the ECLAC Agenda.

Congressman Luiz Carlos Hauly (Brazil) believed that Latin America should follow the example of the United States in terms of tax burdens because they are strongly progressive in income tax and low in indirect taxes, all of which strengthens global trade.

Senator Alfredo Luis Jaeggli (Paraguay) commented that in his country the problem of whether or not to increase the tax burden, which is currently at 10%, is being discussed. He said that following the introduction of MERCOSUR, Paraguay ceased to obtain significant revenues from tariffs, hence its total tax burden declined.

He believes that countries with weaker economies should not increase the tax burden since this affects people with higher income and, therefore, affects investment and job creation. An increase in taxation ends up affecting national competitiveness. He therefore felt that any harmonization should take account of the situation in each country.

Congressman Francisco Monarrez (Mexico) acknowledged that every country has its own economic reality and that should be kept in mind when considering the tax burden. Therefore it is not possible to adopt a tax system from a single foreign country just because it has worked there. As to the question of which kind of tax should be preferred, the trend is to favour indirect taxes over direct taxes.

Senator Juan Carlos Restrepo (Colombia) highlighted the negative impact of constantly creating new taxes because this mainly affects foreign investment. It is logical to maintain the principle of stability since it is the only way to allow for long-term planning. The lack of simplicity in the tax system is also negative. The solution seems to be to broaden the base and create a consumption tax to avoid tax evasion.

Congressman Jesus Martinez (Mexico) maintained that instead of harmonizing tax systems, which is difficult given the differences among countries, there should be harmonization of the general rules or criteria to promote things such as: (a) simplification of tax systems, (b) equity based on the ability to pay of the taxpayer, (c) long term legal certainty, (d) selectivity in the application of certain taxes, (e) a progressive system of income tax with fewer levels, and (f) a broader tax base.

3. Recommendations

Considering the above, the following RECOMMENDATIONS were agreed on.

Aware of the diversity in the tax systems of the countries present at this Forum and of the importance of moving toward greater harmonization of tax structures and mechanisms in a regional context of cooperation, all institutions should be encouraged:

1. To promote the following general proposals:
 - a. simplification of tax systems;
 - b. equity based on the ability to pay of the taxpayer,
 - c. long-term legal certainty of legislation,
 - d. selectivity in the application of certain taxes,
 - e. a progressive income tax system with few levels,
 - f. a broad tax base,
 - g. stronger Tax Administrations,
 - h. better systems of tax control.
2. To include the subject of harmonization in talks on trade agreements in the Americas.
3. To reduce informality in economic activity.
4. To strengthen transparency and accountability in fiscal accounts.



5. To recognize the importance of spending efficiency and to consider the creation of a structural fund to leverage growth in countries with weaker economies.
6. To establish a permanent working group with technical support in FIPA to conduct an ongoing study of the simplification and harmonization of tax systems and disseminate best practices in the region.
7. To include the subject of monitoring fiscal spending from the standpoint of legislatures in ECLAC's agenda.

The Honourable Luiz Carlos Hauly, Congressman of Brazil
Chair of the Working Group

Javier Rosselot Jaramillo, Secretary

4. Annex 1 – Participants

Senator Celso Jaque	Argentina
Dave Burgos, Member of Parliament	Belize
Senator Michel Biron	Canada
Senator Mac Harb	Canada
Senator Juan Carlos Restrepo	Colombia
Congressman Sergio Díaz-Granados	Colombia
Congressman Carlos Hidalgo	Chile
Congressman Carlos Ignacio Kuschel	Chile
Congressman Juan Masferrer	Chile
Congressman Freddy Ehlers	Ecuador
Congressman Salvador González	Guatemala
Congressman Lester Reyna	Guatemala
Congressman Carlos Morales	Guatemala
Congressman Víctor Gutiérrez	Guatemala
Congressman Jesús Martínez	Mexico
Congressman Francisco Monarrez	Mexico
Senator Alfredo Luis Jaeggli	Paraguay
Congressman Carlos Samudio	Paraguay
Congressman Edgar Venialgo	Paraguay
Congresswoman Jhannett Madriz	Venezuela