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Explorations | Exploraciones

Towards a Fiscal Sociology of Latin America

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Abstract

Tax systems in Latin America are characterized by low collection, a higher incidence of regressive taxes and mechanisms, little redistribution, and poor compliance. Policymakers and international organizations have proposed reforms across the region with the aim of increasing revenue for social expenditures and sustainable growth. These challenges, however, are not new: Latin American countries have historically tried to build effective and egalitarian tax systems. This article illuminates the relationships between individual and state whereby citizenship and social cohesion take central stage. To do this, it examines different strands of literature and suggests new avenues for research. The article explores three dimensions of the social relations underpinning taxation: the building of citizenship through cooperation, the role of interest groups in the design and implementation of fiscal policy, and the resulting building of state capacity. These three relational dimensions open a research agenda on a fiscal sociology in Latin America, focusing on the social relationships that sustain and are created by fiscal arrangements. *Keywords*: Fiscal sociology, tax reform, inequality, state building, Latin America, democracy.

Resumen: Hacia una sociología fiscal de América Latina

Los sistemas tributarios en América Latina se caracterizan por una baja recaudación, una mayor incidencia de impuestos y mecanismos regresivos, poca redistribución y un bajo cumplimiento. Los diseñadores de políticas y las organizaciones internacionales han propuesto reformas en la región con el objetivo de aumentar los ingresos para gastos sociales y un crecimiento sostenible. Sin embargo, estos desafíos no son nuevos: los países latinoamericanos históricamente han tratado de construir sistemas tributarios efectivos e igualitarios. Este artículo ilumina las relaciones entre el individuo y el estado donde la ciudadanía y la

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cohesión social toman un lugar central. Con este objetivo, examina diferentes corrientes de la literatura y sugiere nuevas vías para investigaciones futuras. El artículo explora tres dimensiones de las relaciones sociales que sustentan la tributación: la construcción de la ciudadanía a través de la cooperación, el papel de los grupos de interés en el diseño y la implementación de la política fiscal, y la resultante construcción de la capacidad estatal. Estas tres dimensiones relacionales abren una agenda de investigación sobre temas fiscales a través del foco de la sociología fiscal en América Latina, centrándose en las relaciones sociales que sostienen y son creadas por los arreglos fiscales. *Palabras clave*: Sociología fiscal, reforma fiscal, desigualdad, construcción estatal, América Latina, democracia.

Introduction

Tax systems in Latin America are characterized by low revenue, the use of regressive instruments – that bear relatively more on the poor than the rich –, little redistribution and poor compliance. In the current context of global commodity booms and busts, limits to economic growth, and the quest for social equality, taxation in Latin America is at a crossroads. Policymakers and international organizations such as the OECD, ECLAC, and IADB have proposed reforms across the region intending to increase revenue for social expenditures and sustainable growth. These challenges are not new: Latin American countries have historically tried, with diverse results, to build effective and egalitarian tax systems. In this exploration, we argue that fiscal sociology offers rich lessons to inform policy recommendations and understand key features of Latin American societies. Though issues such as tax morale and cooperation – the very conditions that make taxes possible – are gaining in importance in international economic and policy debates (e.g. CEPAL, 2019), fiscal sociology may stimulate new avenues of research and provide crucial results to confront several challenges of current tax regimes. Its focus on the historical and relational dimensions of taxation reveals the social fabric that underpins and makes a fiscal pact sustainable. This helps understand unforeseen failures of tax reform but also several successes, such as improved compliance, and reduction of poverty and labor informality (Gómez Sabaíni & Moran, 2014). In what follows, we briefly touch on the historical context of policy advice. Next, we explore three dimensions of the social relations underpinning taxation that are beginning to draw the attention of policymakers: citizenship, interest groups, and state capacity. We conclude by suggesting a research agenda along these three relational dimensions of taxation.

Change and continuity: fiscal policy prescriptions in Latin America

Despite changing fashions within the social sciences, policy prescription has aimed to strengthen state capacities and promote equality. In the 1950s and 1960s, fiscal reform was discussed against the background of industrial policies, which usually fall under the rubric of import substitution (ISI). The economic failures of previous decades were put down to old forms of revenue production. Taxes on foreign trade and mainly the export of commodities and natural resources, among others, deepened uncertainty over revenue across the region and/or affected the consumption of lower income groups. Technical advice advocated building autonomous capacities through industrialization and direct taxes on income, as well as improving fiscal administration and training fiscal officers.

Richard Goode, later the first director of the IMF's Fiscal Affairs Department (1965-1981), spearheaded the attempt to modernize Latin American fiscal administration. Goode (1965) identified several requisites to build a modern income tax system: a predominantly monetary economy; taxpayers' "high standard of literacy"; reliable accounting records; taxpayers' voluntary compliance; a political system not dominated by the rich; and an honest and efficient administration. In sum, Goode focused on both structural conditions, such as a monetary economy, and social conditions, such as voluntary compliance and cooperation. Considering the absence of some of these conditions, in Goode's (1965) opinion many Latin American countries could not generalize the income tax to their whole populations. Similarly, pointing to gross wealth disparities, Tanzi (1966) recommended taxing the top 5 or 10 percent of taxpayers, making the system progressive, while taxing the rest, mainly the working classes, through sales taxes and social security contributions.

These discussions were soon forgotten as the economic instability of the 1970s and 1980s prompted new solutions to Latin American fiscal crises (Mahon, 2004). Moving away from direct taxes on income, organizations such as the IMF and the World Bank recommended the consolidation of fiscal capacity through value-added taxes (VAT). In contrast to income taxes, VATs were levied on whole populations but remained hidden in prices. The levels of tax collection rose dramatically. VAT-derived revenue increased from around 23 percent of total collection in 1990 to more than 32 percent in the 2000s – far more than the OECD's 20.5 in 2012. The VAT became the most productive tax of most taxation systems of the region. A smaller but more efficient state seemed to be the goal of most of these 1990s reforms. In this context, taxes on trade and income lost importance. Although productive and easy to collect in the context of fragile states, the VAT has a strong regressive impact in the region, as it is well documented (Gómez Sabaíni & Morán, 2014). It bears on the consumption of lower-income families, and its regressive effects have not been offset by progressive personal income taxes whose base is still too narrow. Analytically, however, policymakers made the distinction between revenue production and social spending. This made sense, as some of the most egalitarian countries boast regressive taxation that is compensated by very progressive spending (Kato, 2003). Through spending, one could overcome tax collection inequalities and validate regressive instruments such as the VAT. However, in Latin America indirect taxation increased to the extent of being the most relevant source of revenue.

In both contexts, policy prescription dealt mainly with fiscal arithmetic, i.e., sought to find the most efficient configuration of taxes emphasizing efficiency of collection over equal sacrifice and civic duties. To be sure, significant efforts have been directed to enhance tax compliance (e.g., transparency enhancement, and fiscal education campaigns). Issues such as tax morale and trust have gained relevance in technical debates as well. Our point is that these (welcomed) efforts seek to make indirect taxation more efficient without making the system more visible, explicit and politically inclusive. At the same time, as Bird and Zolt (2015) point, "during the last decades social mobility has increased the pressure over the system to be perceived as fair." While a growing middle class means that more people are now in direct contact with the tax system, raising the salience of fiscal issues (Bird & Zolt, 2015), the number of taxpayers of the personal income tax is still very narrow. As the majority of the working population is not liable to the personal income tax (OECD/IDB/CIAT, 2016), they are not part of the most visible, progressive, and politically explicit link between a citizen and the tax system. In this context, besides transparency and education efforts, tax policy did not require a significant investment in political community building. Citizens were expected to participate in the political community as recipients of social spending, as well as to trust the state and act according to the law (i.e., paying the VAT), but not necessarily as active taxpayers (i.e., income tax taxpayers). Although the state's extractive capacity increased, its relation to different groups of society remained unequal, thereby potentially reproducing political inequalities. Gains in compliance and cooperation have probably been more a product of administrative modernization than of a sense of equality through tax assessment and contribution.

The social relations underpinning taxation

There are excellent economic and policy studies about the impact of fiscal policy on income distribution and poverty reduction in Latin America (Lustig, Lopez Calva & Ortiz Juarez, 2013). There are ever more refined studies that assess the specific impact of redistribution programs on wellbeing, and how social spending can improve regressive fiscal regimes (Goñi, López & Servén, 2011). It is noteworthy the effect of taxation, but particularly spending, on the decrease of inequality in some countries over the first two decades of this century – although explanations vary and do not seem to be the same for every country. This is not only an important issue for developing societies as distributional outcomes shape the legitimacy of fiscal and state policies and affect key relations that underpin taxation (e.g., tax morale and willingness to pay taxes). Without neglecting this issue, we contend that, following recent research in the region, an agenda for a fiscal sociology in Latin America can profit from studying three relational aspects of taxation: The building of citizenship through cooperation, the role of interest groups in the design and implementation of fiscal policy, and the resulting construction of state capacity.

Citizenship

Fiscal sociology distinguishes between two broad models of revenue extraction: One that stresses the coercive capacities of the state to force citizens into paying taxes, and other that highlights the capacity of the state to gain trust and command the necessary consent from citizens (Brautigam, Fjeldstad, & Moore, 2008). Research finds consent is more stable and productive for state formation in the long-run. States that manufacture consent through representative institutions and citizens' trust can reduce transaction costs involved in assessment and supervision, limiting the costly use of coercion. Consent has been framed as a contractual model of taxation (Kiser & Marceski, 2017) in which citizens and state explicitly link contributions to rewards, creating a healthy cycle of accountability and stable expectations. Taxation is also a way to formalize the basic reciprocity in society (Martin & Prasad, 2014), a leap of faith in which a community accepts to be taxed for common objectives (Steinmo & Bergman, 2018). The determinants of compliance, consent, and cooperation depend on how a political community understands and monitors its obligations. This underpins state capabilities to elicit trust through credible commitments and coercive means.

Horizontal solidarity – between citizens – is crucial to the construction of vertical solidarity – between citizens and state –, which enhances state capacity and allows fiscal redistribution. A society is more likely to accept being taxed when people think that they are part of a community, whose protection and development is understood as a collective endeavor. If people think they are taxed unfairly relative to other people, state capacity is undermined. In this light, considering socio-economic differences is crucial for any fiscal pact aiming to be fair and legitimate. If people think the state uses public resources in a discriminatory and unfair way, its capacity is probably going to be compromised. The recent boom in sociological fiscal studies in Latin America arises from the need to understand the social – horizontal, reciprocal – relations underpinning taxation (Sánchez Román, 2012). Even though recent revenue growth in Latin America results from the introduction of the VAT, Bergman's (2009) comparison of Argentina and Chile stresses the social relations that make such a reform possible. As Bergman makes clear, the relative success of the latter was in no small part thanks to investment in both state credibility and horizontal trust between taxpayers. Believing others pay taxes is a form of self-monitoring and increases the likelihood of compliance.

In this light, fiscal sociology contributes to our understanding of Latin American democracies through its focus on the construction and formalization of civic obligations. Tax compliance is not only a byproduct of a contract between state and citizen but also a byproduct of social life, a contract among citizens (Biehl & Labarca, 2018). When technical considerations exclude citizenship, revenue bargaining (Brautigam et al., 2008), and social cohesion, they run the risk of increasing the efficiency of collection and spending at the cost of hiding and undermining the social fabric that originates them in the first place. Relational aspects of taxation give meaning to democracy and citizenship. That leaves two important questions open. Given the fractious relation between Latin American states and societies, the first question is about the power of different interest groups that could undermine broader fiscal pacts and an egalitarian understanding of civic obligations. The second question deals with how these patterns of relationships between states and actors boost or undermine state capacities in the long run.

Interest groups

The role several interest groups play in the evolution of Latin American tax regimes has received much attention in the last decades. This is not a particular aspect of Latin America: taxation is a contentious issue in many countries. It does not affect taxpayers in the same way, thus making it impossible to reach consensus over appropriate tax policies. Studies dealing with interest groups mainly examine the role played by state elites, business groups, and other collective actors in bargaining processes and diffusion of tax policy ideas. A focus on these groups sheds light on power conflicts within or between countries, as well as on the global economic and political position of Latin America–a 'transnational dimension'. These actors depict clearly the relational dimension that defines the development of tax systems, which involves different levels of influence and access to resources, and reflects a specific balance between rights and duties (Murphy & Nagel, 2002).

The influence of elite struggles has been used to explain different patterns of state-building and the adaptation of Latin American tax systems to globalization processes. On the one hand, some works focus on bargaining between state elites and high-income taxpayers to analyze institutional performance and the outcomes of tax reforms (Mahon, 2004). For Saylor (2018, p. 33), Latin American states' extractive capacity is associated with coalitional politics subjected to the relationship of ruling coalition members to the country's credit market. Biehl and Vera (2014) propose that variations in the fiscal pact reveal conflicts between the goals of tax collection and changes in state and business capacity – involving technological adaptations and the challenge of granting property rights while enforcing the law. On the other hand, negotiations between local and national elites are highlighted. For instance, Schneider (2018) considers how the relationship between federalism and taxation conditions tax collection and state capacity, and Kurtz (2013) points to the lack of emancipation of servile labor force alongside traditional oligarchies as factors blocking institutional building.

Beyond elite struggles at different levels, several studies concentrate on the patterns of organization or coordination within elites, particularly business elites. These works illustrate the power and strategies of the very wealthy to gain influence in public decision-making – i.e., to reduce their tax burden or prevent progressive reforms. For example, Tasha Fairfield (2015) finds that mobilization of instrumental and infrastructural power hampers tax administration. Business groups strongly influence lawmaking to reduce the redistributive effect of tax reforms and mechanisms to enforce compliance. Other studies underline the degree of cohesion in business groups, which can influence political mobilization, as well as bargaining strategies (e.g., Castañeda, 2018).

From a different angle, Latin American tax regimes have also been influenced by other collective groups, which are decisive either to value the role of tax systems or to produce specific outcomes in contexts of tax reform. For instance, public opinion and social leaders' negative evaluations of the tax system in Argentina are emphasized (Grimson & Roig, 2011), as they devalue the role of taxation and undermine public policy's effectiveness. In a different vein, some authors analyze the pressure taxpayers and consumers can exert through protests, boycotts, or public criticism. This illuminates the state of the fiscal bond and the many ways citizens' groups can express their satisfaction or dissatisfaction with specific taxes or tax policies (Atria, 2019; Fairfield, 2015).

State capacity and political community building

Fiscal sociology has been long interested in what determines states' capacity to raise revenue effectively, and to spend it virtuously (i.e., securing increased revenue, economic growth, and redistribution). State capacity is commonly measured as the extent to which states penetrate society and impose their authority. State's geographic boundaries are defined by its power to tax constituents, a measure of its extractive capacity (Cheibub, 1998, p. 350). State weakness is often related to little tax collection, economic underdevelopment, and economic and political inequality (Brautigam et al., 2008). To enhance state capacity, the creation of a national political community is crucial, which inevitably entails bargaining between state and citizens – a fiscal pact.

The fiscal pact shapes social trust. Historical sociology often finds that the generalization of domestic taxes precedes democratization. The demands for contributions and sacrifice are a byproduct of citizenship formation (Ross, 2004). Through visible instruments, such as domestic taxes on income and wealth, societies formalize rights and duties that define citizenship. The crucial tax here seems to be the personal income tax, which is visible and explicitly links and formalizes an obligation. In Latin America, however, taxation's principle of equal sacrifice is associated in practice with consumption and imports, as tax regimes have mostly relied on indirect taxes. This had the unintended political consequence of making taxes invisible and constricting democratic deliberation. Fiscal issues lost salience, which diminished fiscal bargaining (Biehl & Labarca, 2018). Historically, fiscal pacts in the region worked under the discourse that elites, through direct domestic taxes, and foreign companies, through taxes on commodities or profits, would fund the state. In the end, it was the citizen through inflation and indirect consumption taxes that bore the brunt of the burden. There is no space for a compensatory theory of progressive taxation in the region (Scheve & Stasavage, 2016).

A different strand of literature analyzes how wars had unintended consequences for state-building. Having in mind European pathways towards welfare regimes, scholars enquire why Latin America did not follow a similar path (Centeno, 2002). Latin American state-building was not similar to European processes, where interstate rivalries acted as critical junctures enabling the rise of the tax state. Instead of external wars, recurrent internal conflicts during the nineteenth century hampered state-building. As famously stated by Centeno, instead of "blood and iron" Latin American states were built on "blood and debt." Recently, however, Rodríguez-Franco (2016) contributes a more nuanced version of the bellicist approach. Not all internal conflicts lead to state weakness: When internal wars generate elite solidarity toward the state, they can improve the state's capacity to tax.

Another line of research focuses on path-dependent processes of national political community building and their institutional consequences. Lieberman defines a political community as "the group of people officially entitled to the rights and responsibilities of citizenship" (2003, p. 3). For him, the "myth" of racial democracy hindered inter- and intra-class solidarity in Brazil, leading to regional cleavages that prevented elite willingness to pay progressive taxes. The result was an adversarial relationship between state and economic elites, as opposed to the more cooperative South African case.

A research agenda for fiscal studies on Latin America

Fiscal sociology involves a multidisciplinary approach. Given the complexities of the relationships between citizens and state, it digs at different levels of analysis. These relationships between state and citizen sustain and are shaped by tax arrangements. In this light, policies that regard the social conditions of taxation are likely to strengthen the very basis that makes taxation possible. This is already apparent in countries where invisible taxes on consumption are gaining prominence in detriment to direct and visible income taxes, such as much of the OECD.

Much of the normative basis to support efficient taxation (e.g., VAT) focuses on the capacity to produce much-needed revenue for Latin American states. By excluding citizens from revenue bargaining, which is left to experts and the wealthy, taxation loses salience. To some extent, this can be considered the historical legacy of an old moral justification for excluding most of society from the income tax: In a context of high inequality and low wages it was impossible to propose mass income taxes. This justification gained support from both conservative and working-class political groupings. As a result, most Latin Americans have been historically exempted from income taxes (and thereby from political deliberation) while expecting to be included into their democracies through social spending. Although their motives are laudable, current policy recommendations strike a surprising similarity with past technical advice. This, we suggest, is a fragile setting on which to build a democracy. In addition to making VAT payment more salient, generalizing progressive visible taxes (and perhaps lowering VAT) could contribute to incentivize public debate about the institutional and social reciprocity that taxes symbolize.

In this exploration, we focused on the social relationships underpinning taxation, though the field is fertile for new questions and methods to address the particularities of each Latin American society. Comparative research could also deepen our understanding of considerable heterogeneity within Latin America, as well as highlight differences and similarities between the region and other continents. Through the lenses of fiscal sociology, we suggest the hypothesis that social equality is not just a technical matter to be achieved through redistribution. It is tantamount of citizenship itself as it defines membership into a political community and allows discussing the important questions of who, how, and for what reason should we tax ourselves.

Other questions that emerge from this exploration relate to the tensions that arise when policymakers and scholars analytically distinguish taxation from social spending. In Latin America both activities have been dealt with separately. As much social spending was traditionally tied to trade and debt, it is not surprising that taxation – as a relation that can establish equal sacrifice politically – seems less prominent in public discourse (e.g., comparatively less frequency of fiscal protest). In this rationale, taxation's goal is efficiency (revenue), while social justice (redistribution) is seen as a separate goal of social policies. The tension occurs in the intersection of both activities, one that fiscal sociology can help to uncover: the social fabric that sustains or makes viable a fiscal pact, which is relevant for both revenue and expenditure. Future studies focusing on taxation as a process, rather than two separate activities, could offer a more adequate understanding of the complexities of fiscal policies. This is particularly important because regressive taxation in the region does not seem to be offset by robust redistribution (e.g., Goñi, López & Servén, 2011), certainly not at the levels achieved by OECD and countries where indirect taxation plays a significant role (Kato, 2003).

Another area of research concerns the political role of interest groups. What are the political and fiscal implications if those who explicitly fund the state gain power to influence tax and social policy? How does the state face the challenge of income concentration if democratic participation cannot neutralize elite opposition to progressive taxes? The vast majority of Latin Americans are subject the VAT, but interest groups can strongly influence policy as they are subject to visible direct taxes. Also, we should be attentive to the regional diversity and past legacies of ethnic exploitation (e.g., the permanence of indigenous tribute in Bolivia for most of the 19th century). Indeed, fiscal sociology could help us identify pathways to include vulnerable groups that have been marginalized from fiscal debates.

The fiscal history of Latin America offers a diverse array of contrasting case studies. Taxation is more than just a technical matter. It offers a wealth of possibilities to understand the relationships between state and society, as well as state legitimacy and political exclusion. In this exploration, we call for further studies of the social relationships that sustain and are created by fiscal arrangements. To grasp how the fiscal pact works, we need to understand the interplay of technical considerations, fiscal needs, and social relations.

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