

POLI 437: International Relations of Latin America

^T Note. These Rivers are
both of them Navigable, and all
the Cannon and Stores for Acapulco
are Carried from the North to the
South Sea by them.



THIS WEEK

What is state capacity,
where does it come from?

Wonk out about tax collection

Approaches to improving capacity

STATE CAPACITY



AN OLD DEBATE

economistsview.typepad.com ▾

[What is the Role of the State? - Economist's View](#)

Sep 8, 2010 - Yet horrors can also befall a society with an **over-mighty state**. ... The more complex the society and **economy**, the greater the range of ... I always suspect that people, who want to **debate** the "role of the state" and "the size of ...

www.pionline.com ▾

[GFOR: Economists debate role of government in economy](#)

Jun 15, 2015 - GFOR: Economists **debate** role of government in **economy** ... expects "the biggest boom in the United **States** you've ever seen" **on** the horizon, ...

www.jstor.org

[State Intervention versus the Market: A Review of the Debate](#)

by S Yahaya - 1991 - Cited by 4 - Related articles

discuss the theoretical **debate** **on** the **role** of the **State** has become urgent, and ... **economic functions** of the **State**, especially in the conditions prevailing in.

history.csac.wisc.edu ▾

[The Debate over Property, Class, and Government – Center ...](#)

In short, Federalists and Antifederalists had different views of the **state** of the **economy**, of the appropriateness of **state** policies to deal with **economic** conditions, of the necessity for changing the Articles of Confederation to improve business and trade conditions, and of the ability of the Constitution to control ...

What kinds of things are states
“supposed” to do?

Security, war (*coercive capacity*)

Enforce contracts

Public goods, infrastructure

Need money to pay for all this!
(*fiscal capacity*)

COERCIVE CAPACITY

Ability of state to **monopolize violence** through police, military

Weak coercive capacity → rebel groups, crime, revolutions

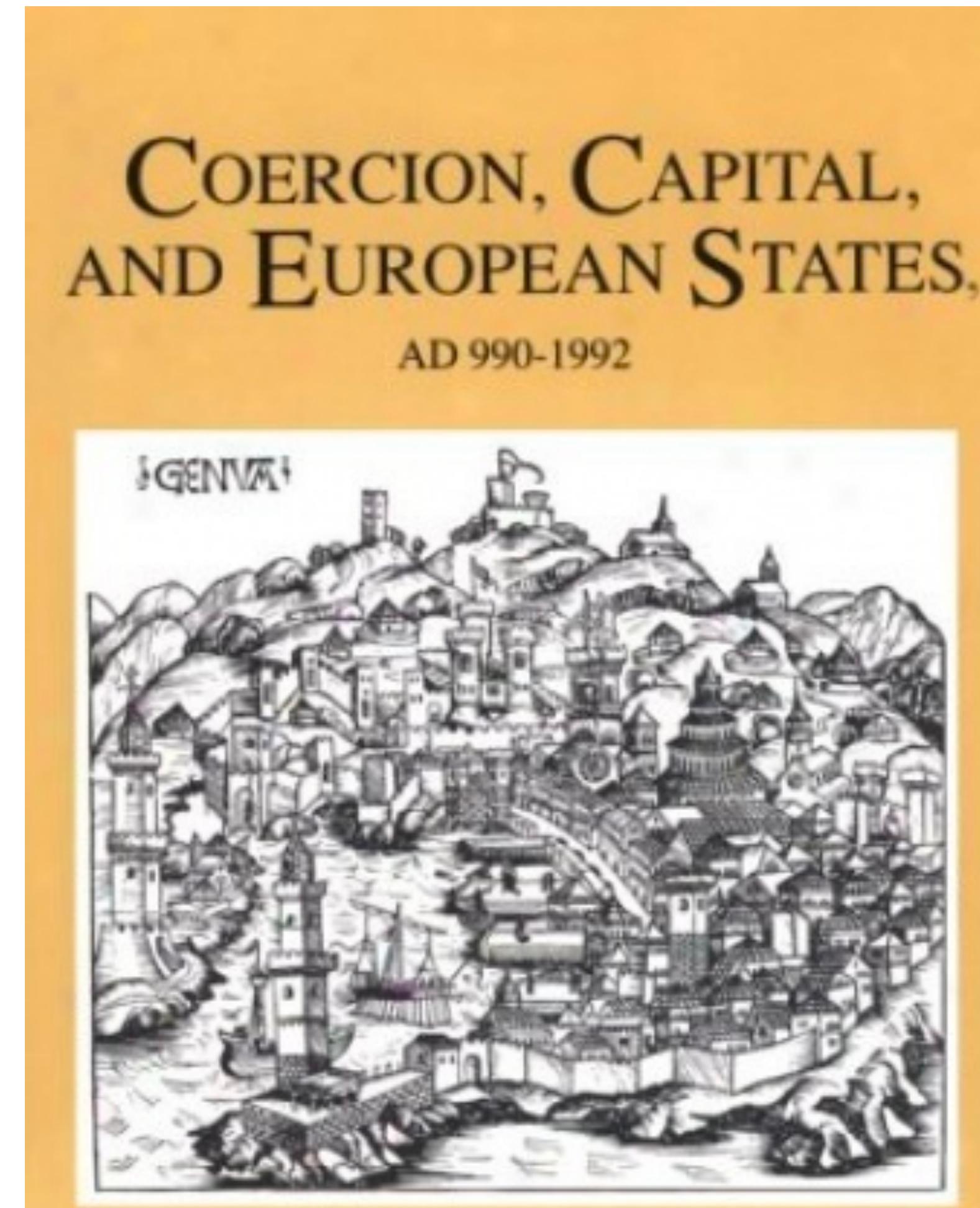


LONG AGO...

Early states became more “capable” in
order to wage war

Extremely expensive wars →
invest in tax collection

Tax collection →
large administrative apparatus



Charles Tilly

First income tax in the US?

Signed by Lincoln, during Civil War, to fund war effort, because
Union was broke!

27th CONGRESS,
1st Session.

H. R. 54.

IN THE SENATE OF THE UNITED STATES.

JULY 19, 1861.

Read twice, and referred to the Committee on Finance.

JULY 25, 1861.

Reported by Mr. Simross with an amendment, viz: Strike out all after the enacting clause and insert what follows printed in italics.

AN ACT

To provide increased revenue from imports, to pay interest on the public debt, and for other purposes.

- 1 *Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,*
- 2 *[That, from and after the date of the passage of this act,*
- 3 *in lieu of the duties heretofore imposed by law on the*
- 4 *articles hereinafter mentioned, and on such as may now*
- 5 *be exempt from duty, there shall be levied, collected,*
- 6 *and paid, on the goods, wares, and merchandise herein*
- 7 *enumerated and provided for, imported from foreign coun-*
- 8 *tries, the following duties and rates of duty, that is to say:*
- 9 *First. On raw sugar, commonly called Muscovada or brown*
- 10 *sugar, and on sugars not advanced above number twelve,*
- 11 *Dutch standard, by claying, boiling, clarifying, or other pro*

EVEN LONGER AGO...

Common wisdom: humans transition to agriculture b/c more food, less risk

Yet fossil record shows people worse off: poor nutrition, shorter, etc.

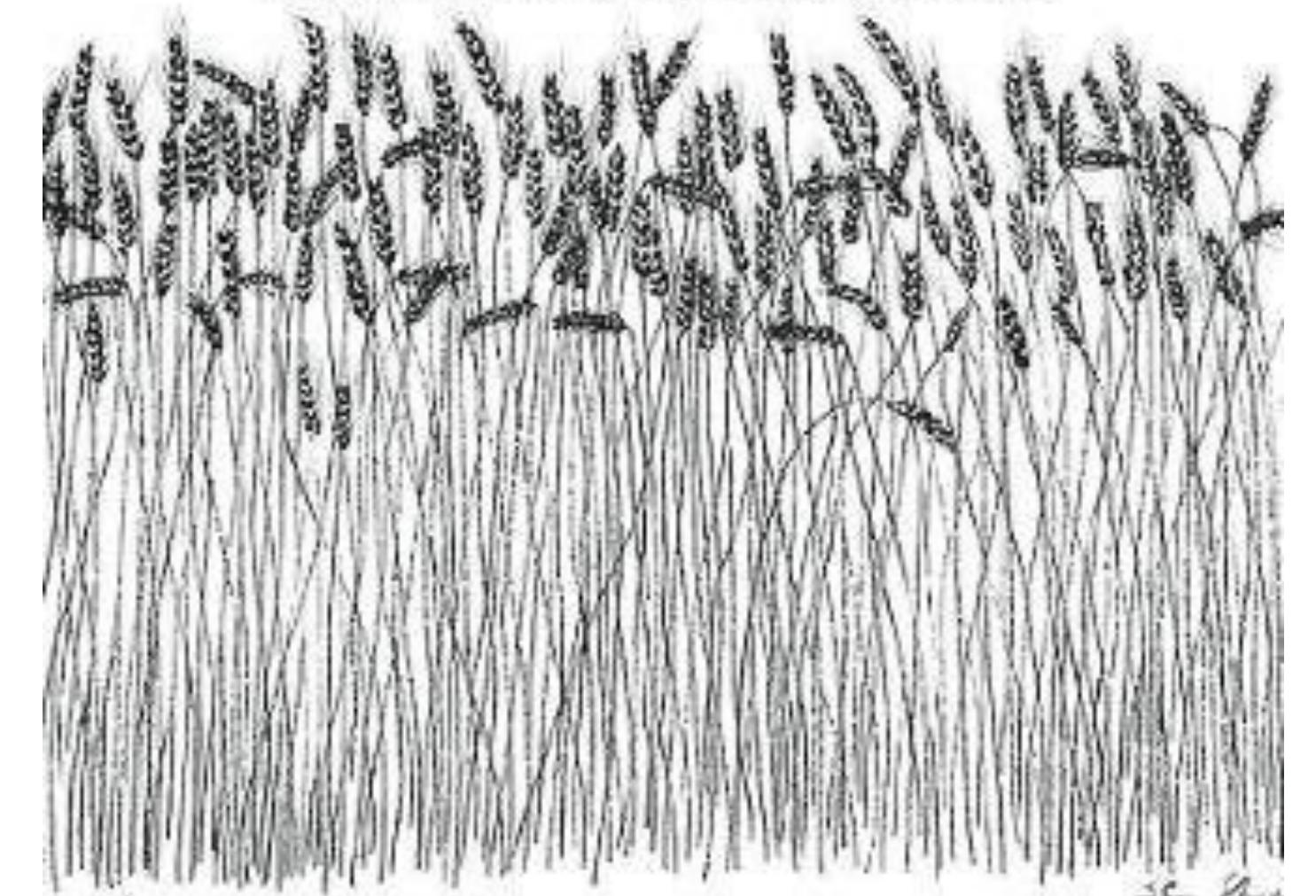
Transition to agriculture basically slavery imposed by warlords

State formation is driven by “taxes”

James C. Scott
AUTHOR OF *SEEING LIKE A STATE*

Against
the Grain

A DEEP HISTORY OF THE EARLIEST STATES

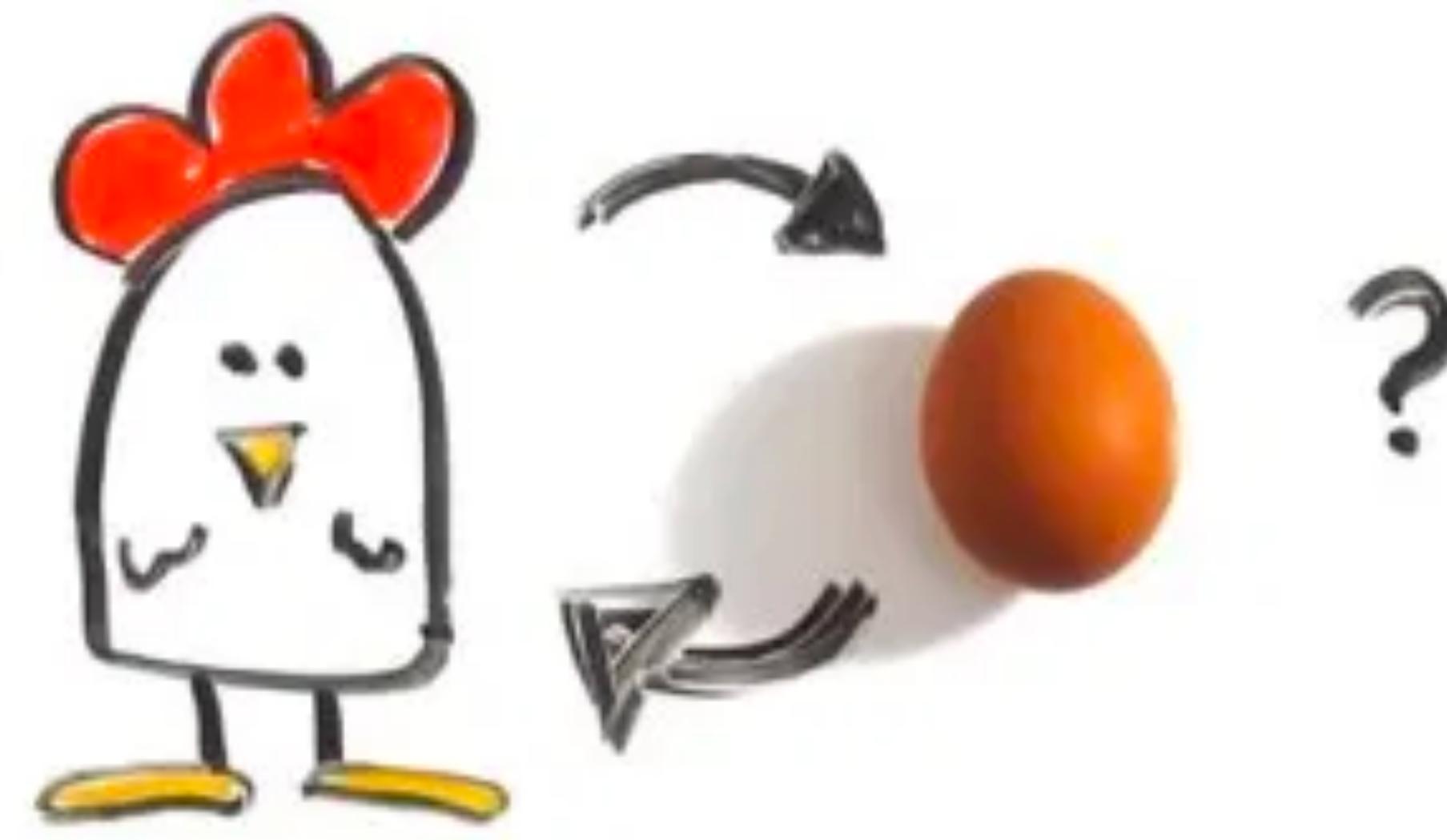


What is (broadly) Bräutigam arguing about
the quality of taxation in the developing
world?

Sort of counterintuitive:
people in poor countries pay ***too little*** in taxes

This is because states in the developing world are ***too weak***
or have little incentive to collect them

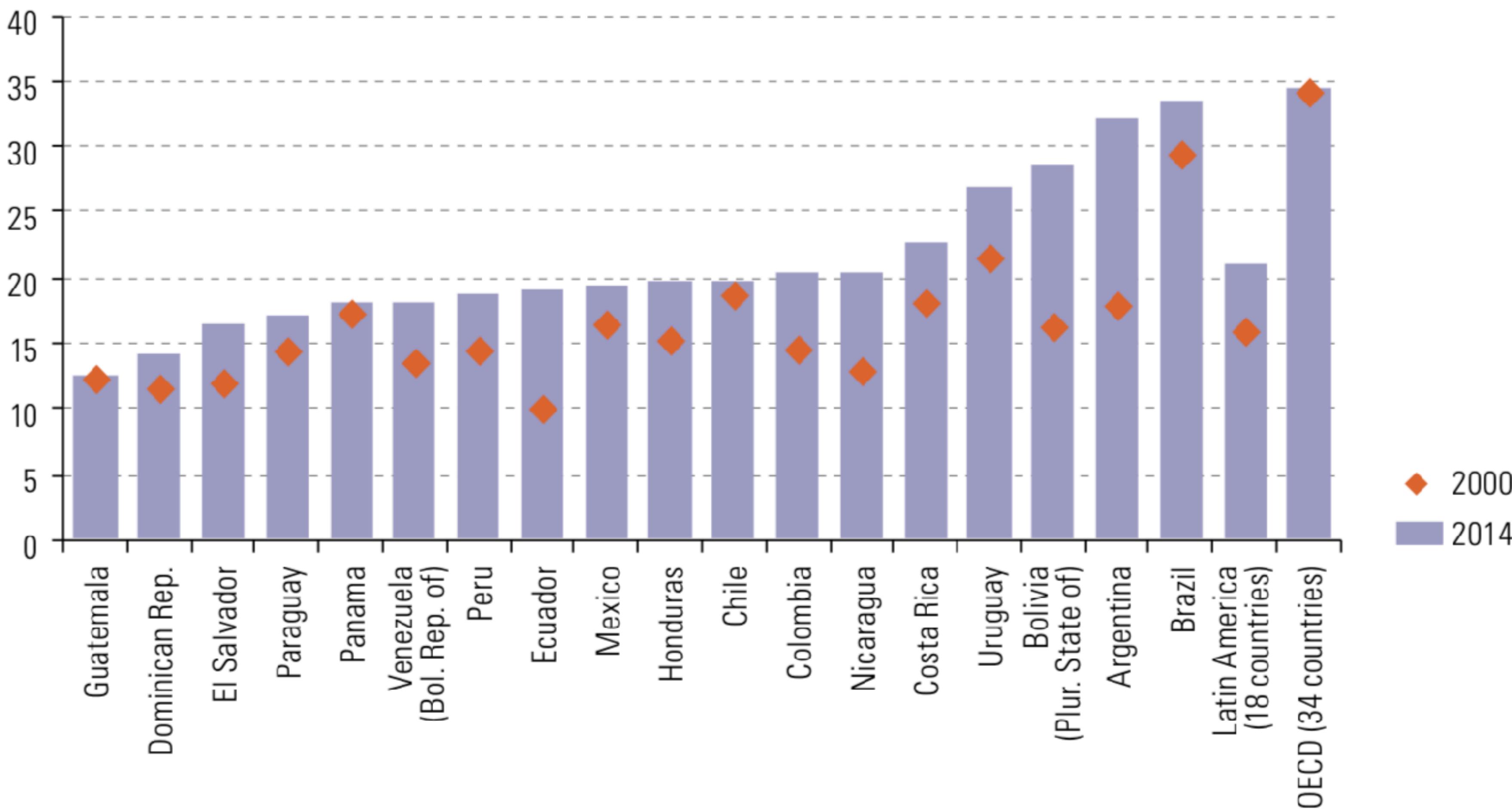
So you need tax money to build capacity, but
need capacity to collect taxes...



'No underdeveloped country has the manpower resources or the money to create a high-grade civil service overnight. But it is not sufficiently recognized that the revenue service is the 'point of entry'; if they concentrated on this, they would secure the means for the rest' (Kaldor, 1963)

Latin America collects (relatively) little in taxes

Still, Latin America's tax burden remains low compared with the developed countries: about half of the average for 15 European Union countries and 15 GDP points below the OECD average (see figure II.9).



What are taxes for?

Infrastructure + investment

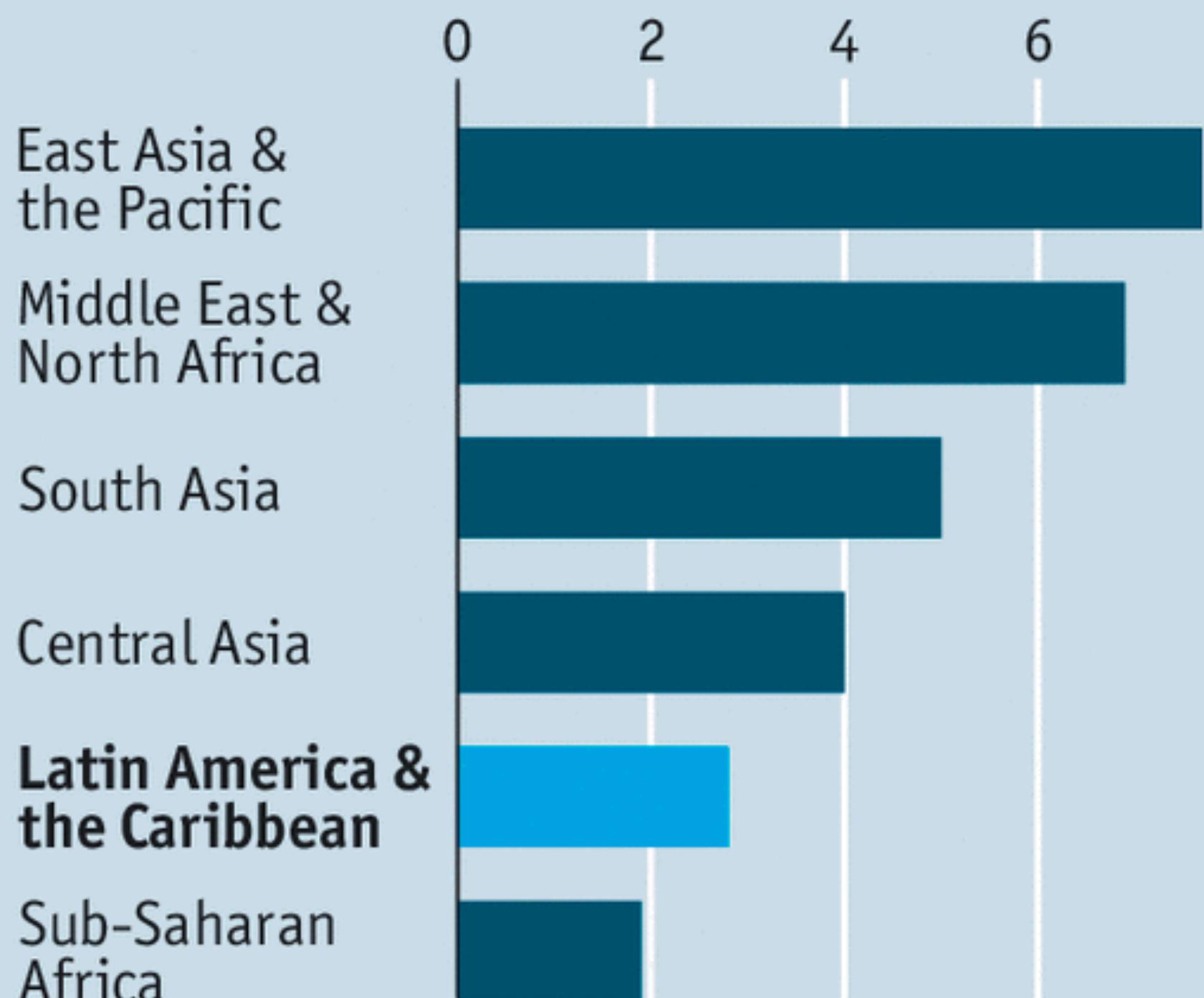
Transfers and redistribution

Central to other forms of state capacity

Taxes used to fund infrastructure, education, health

Slow roads to prosperity

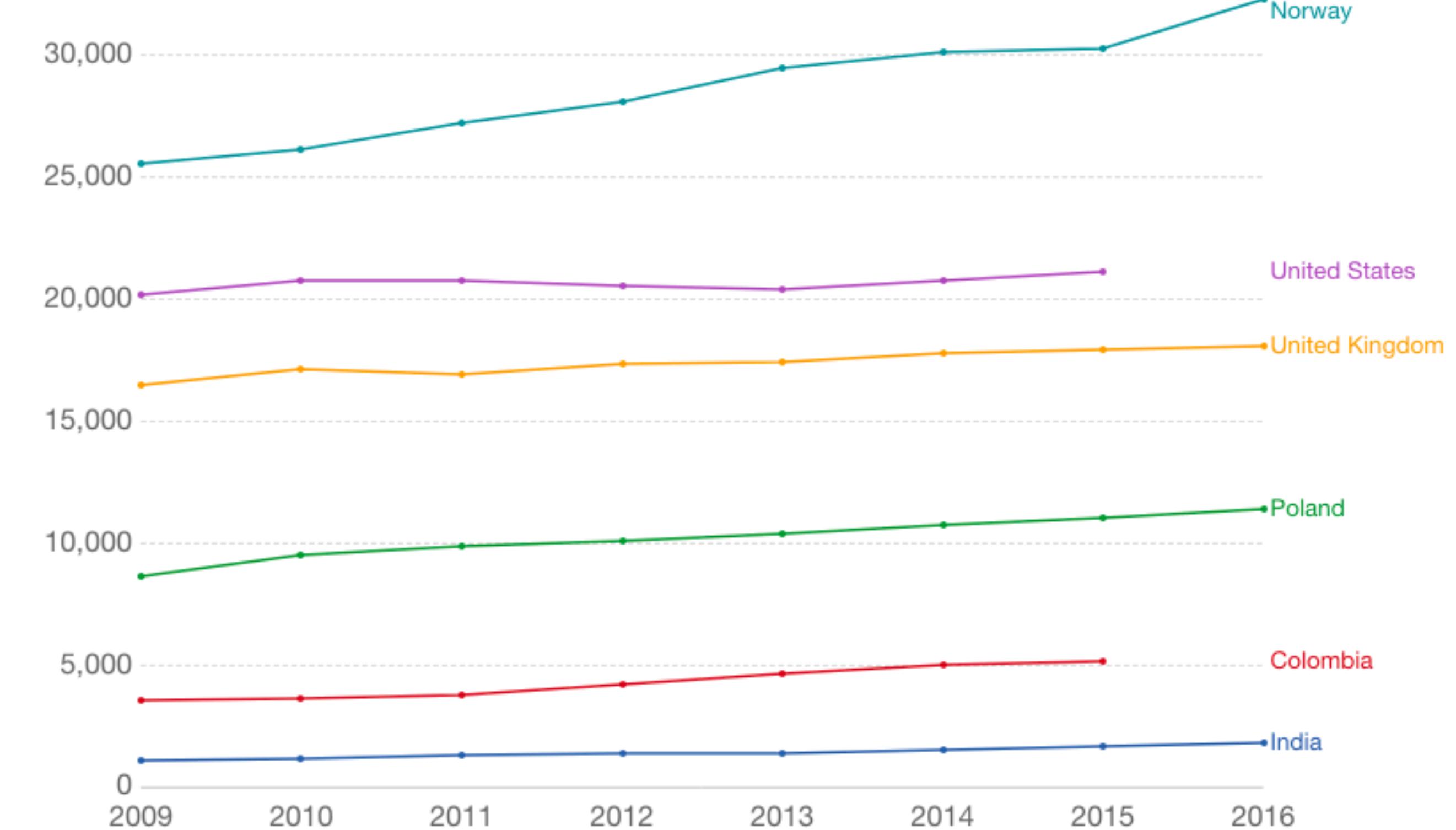
Public and private infrastructure investment
2017, % of GDP



Source: World Bank

Total government expenditure per capita (USD PPP)

Total government expenditures across all levels of government. Expenditures include intermediate consumption, compensation of employees, subsidies, property income, and social benefits.



Source: Government at a Glance – OECD (2017)

OurWorldInData.org/public-spending/ • CC BY

Why is so little tax collected in Latin America?

Part of answer is a very narrow **tax base**:
little capacity to tax **income and assets**

In LAC, only ~10% is registered tax payer;
~60% in developed world

Income and assets are hard to tax, even in rich countries

Data problem: need accurate information on citizen's economic activities

Enforcement problem: need bureaucracy to verify and go after people

Especially challenging in Latin America

“SHADOW” ECONOMY

~ 50% of all workers are **informal**
(in Honduras, Guate ~ 70%)

Huge variety of jobs: not just
street vendors

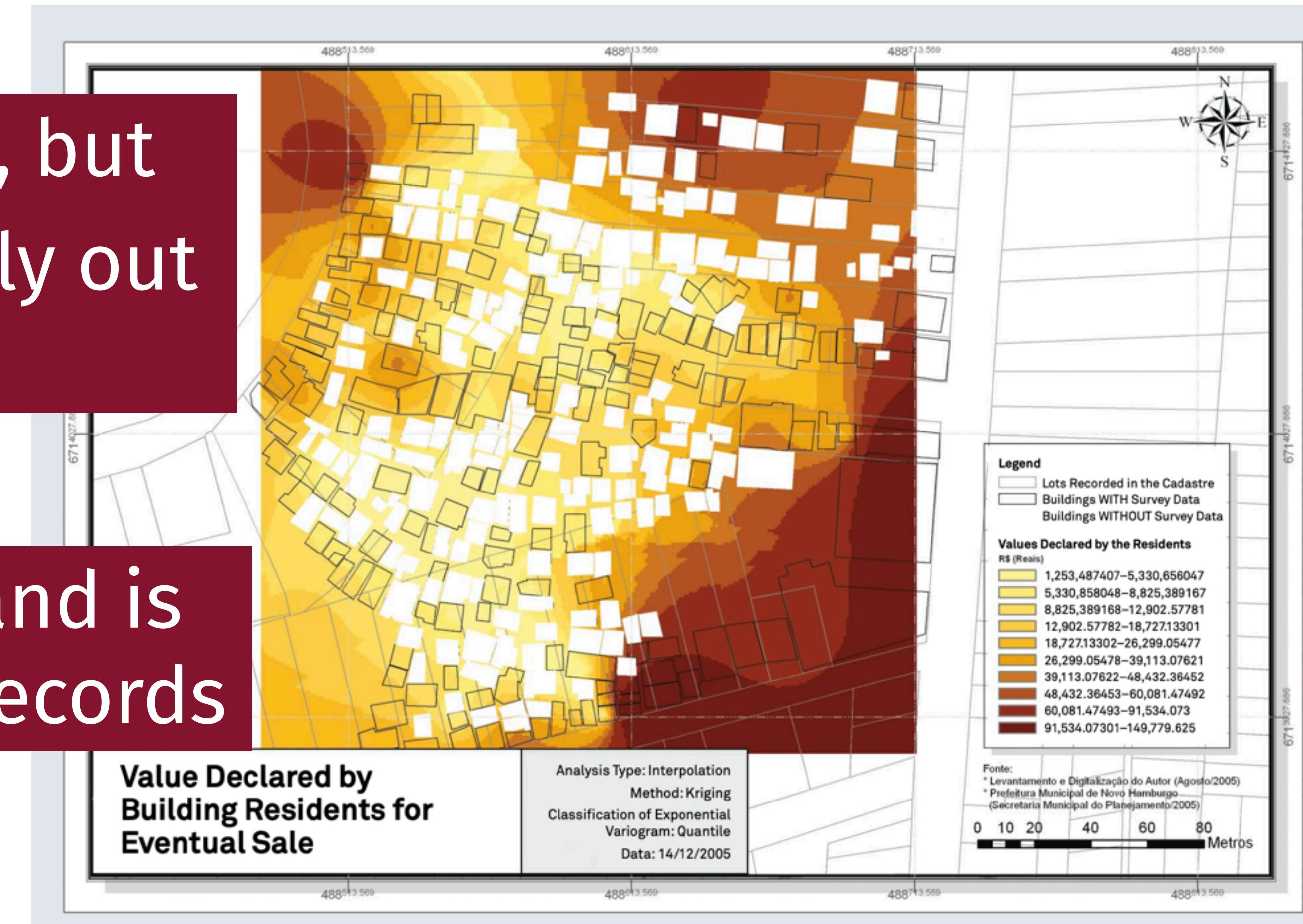
No payroll, no record of payment,
mostly cash businesses



THE LAND PROBLEM

Property taxes based on value, but
land cadasters in LA are woefully out
of date or missing

In Colombia, approx. 60% of land is
untitled or missing from state records



THE PRODUCTIVITY PROBLEM

Table 3. Tax Collection and Tax productivity

Region	Collection (% of revenue)		Tax Productivity	
	Income	VAT	Income	VAT
East Asia Pacific	34.38	25.45	0.15	0.36
Latin America and the Caribbean	18.27	36.83	0.08	0.33
Middle East & North Africa	16.93	29.05	0.07	0.32
OECD	25.87	25.96	0.15	0.34
South Asia	23.02	29.61	0.05	0.18
Sub Saharan Africa	23.00	33.10	0.11	0.33

Source: Author's calculations based on Eichhorn (2006), WDI 2006, OECD tax Database, Doing Business Database.

**Tax productivity = actual tax
collected / nominal tax**

**Low productivity = lots of allowances/
loopholes**

THE OFFSHORE PROBLEM

Country/region	Offshore financial wealth	Offshore share of national financial wealth
Europe	2 600	10
United States	1 200	4
Asia	1 300	4
Latin America	700	22
Africa	500	30
Canada	300	9
Russian Federation	200	52
Gulf countries	800	57
World	7 600	8

Source: G. Zucman, *The Hidden Wealth of Nations. The Scourge of Tax Havens*, Chicago, University of Chicago Press, 2015.

Weary of taxes and expropriation,
elites **hide wealth abroad**

Large corporations, wealthy individuals use accounting loopholes to lessen tax burden

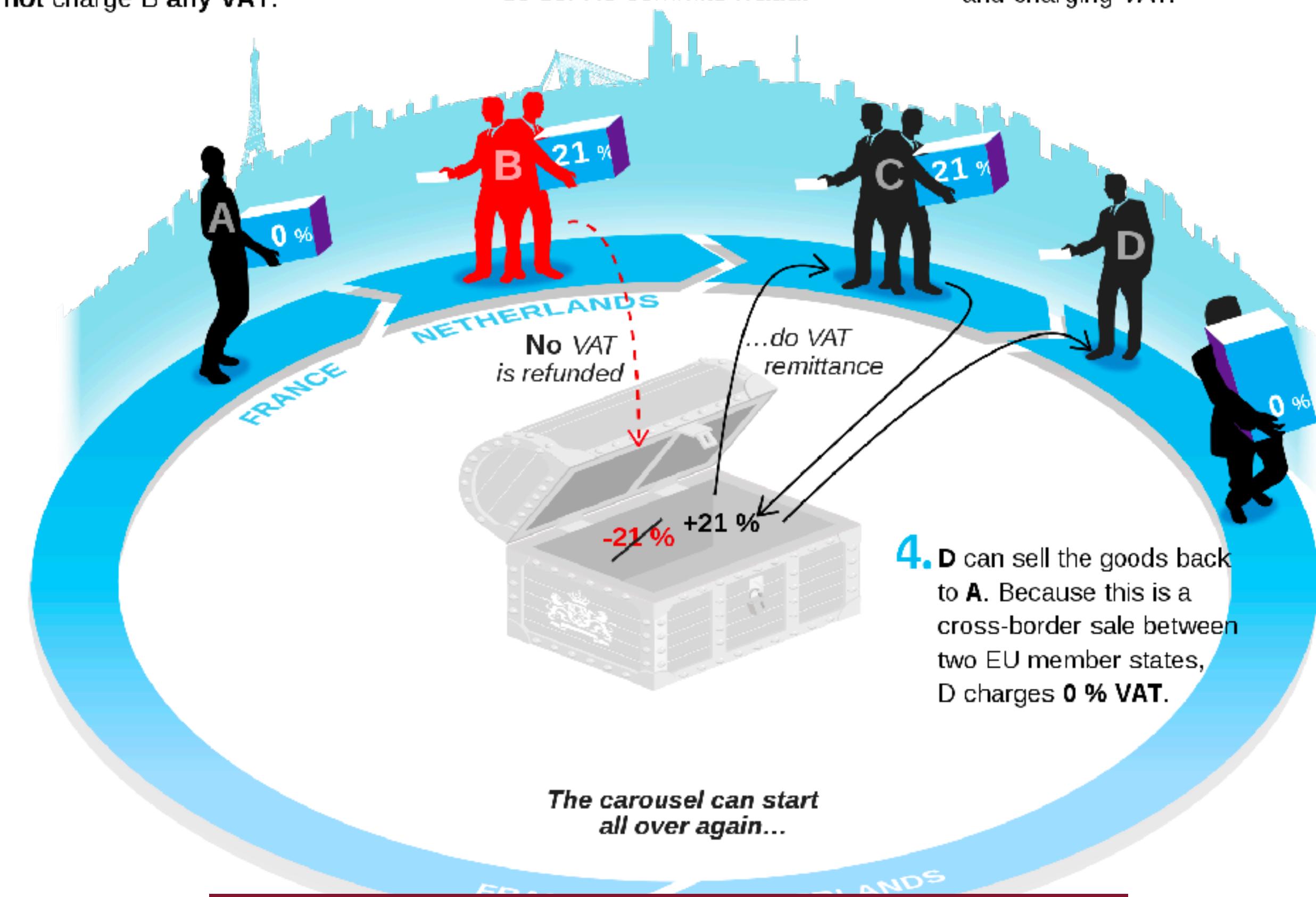
Transfer pricing:
Colombian coffee co. sells to
Costa Rica subsidiary, **low** price

Costa Rica subsidiary sells to
USA at **artificially high** price

Missing trader fraud

In carousel VAT frauds, a merchant fails to remit VAT to the taxing authority, despite charging his buyers the price of the sold goods plus VAT.

1. Business A delivers goods to B in the Netherlands. Because this is a cross-border sale within the EU, A does **not** charge B any VAT.
2. B sells the goods to C and charges him 21 % VAT. He has to remit this to the taxing authority, but **fails to** do so. He commits **fraud**.
3. C has payed 21 % worth of VAT to B, which he can deduct on his VAT return. C delivers the goods to D and charging VAT.



Whatever this is

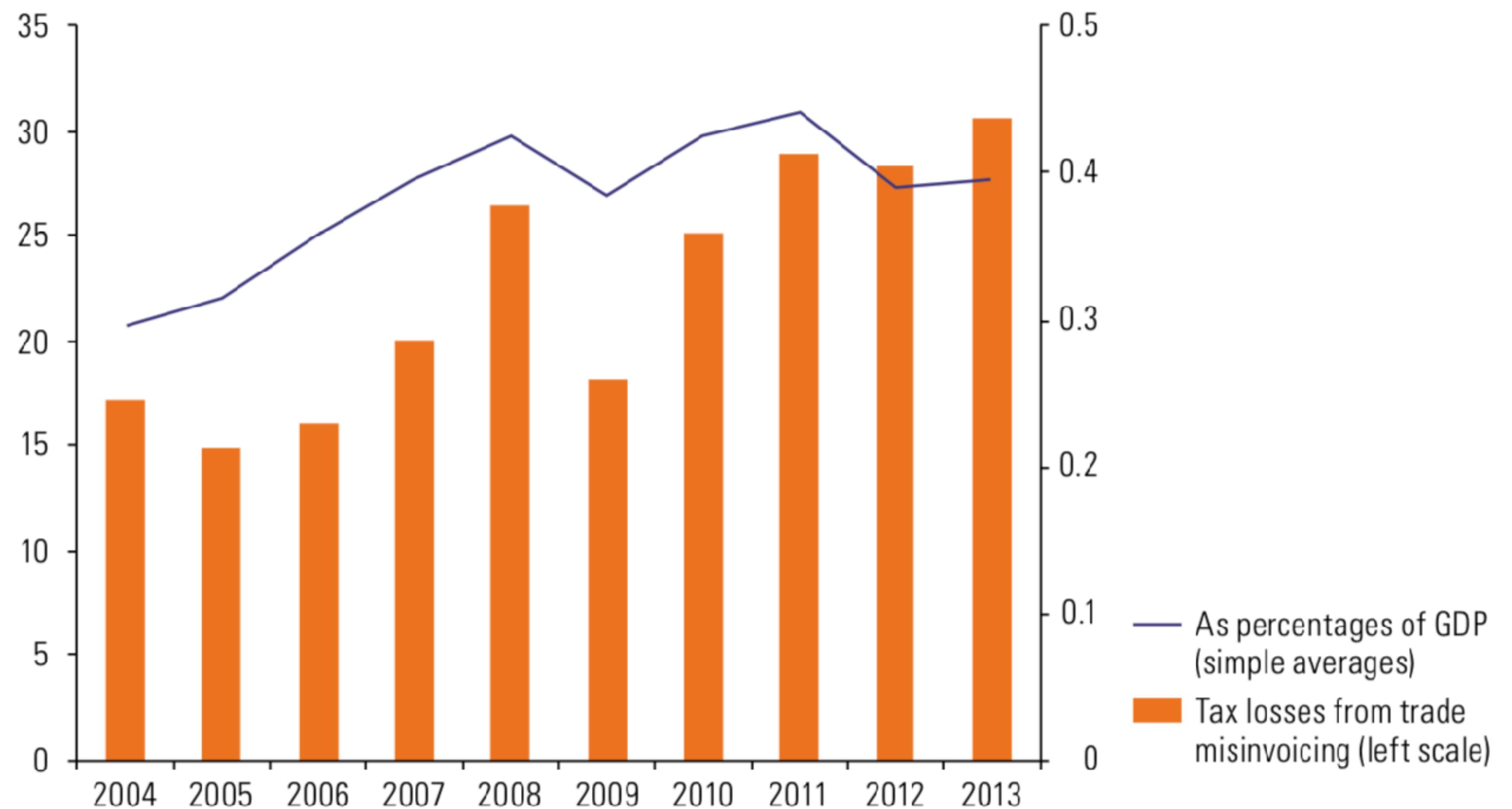
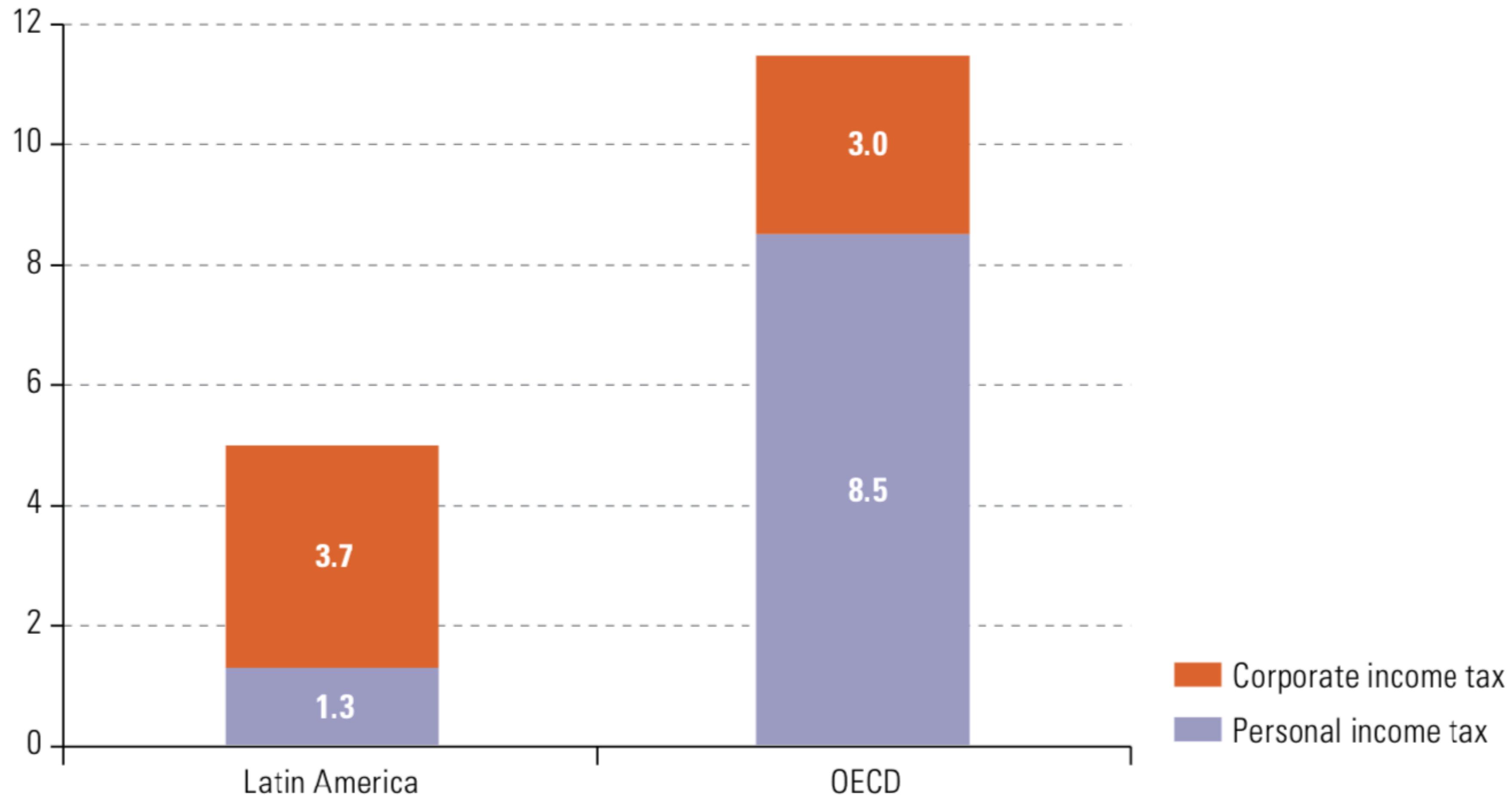


Figure III.1
Latin America and the Caribbean: tax losses associated with trade misinvoicing, 2004-2013
(Billions of dollars and percentages of GDP)

Source: Economic Commission for Latin America and the Caribbean (ECLAC).

\$31 billion, just from
trade mis-invoicing



Source: Economic Commission for Latin America and the Caribbean (ECLAC), on the basis of official information.

^a Does not include Cuba or Haiti.

LA countries collect < 1/5 of personal income taxes that OECD countries collect

Property and income too hard to go after, so Latin American countries are relying more on **Value-Added Taxes (VAT)**

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Source: Author's calculations based on Eichhorn (2006), WDI 2006, OECD tax Database, Doing Business Database.

What are VATs? And what's attractive about them?

Basically a sales tax, but at every stage of production

Easier to tax companies instead of people (fewer)

10% Sales tax:
Baker buys flour for \$1,
Sells bread to bakery \$3,
Bakery sells bread for \$4
10% tax = 40 cents

10% VAT:
Baker buys flour for \$1 (tax = 10c),
sells bread to bakery \$3
(tax on *value added* \$2 = 20 cents),
bakery sells bread for \$4
(Value added tax = 10 cents)
Total = 40 cents

VAT collects the same amount as a sales tax

The trick is that **each person in the chain has an incentive to report income**

When baker buys flour, it's in their interest to report to tax authority so they can reduce their own tax burden

That gives tax authority info on **flour producer's income**

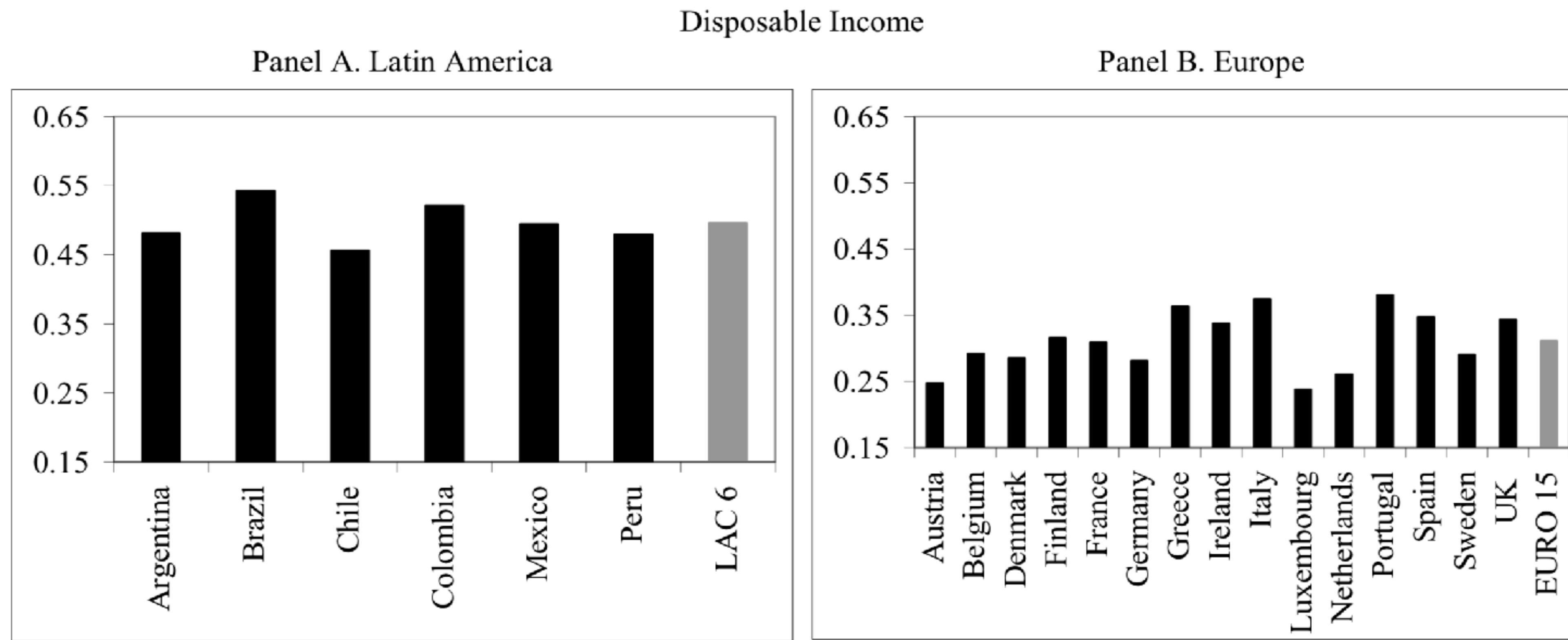
Wow! awesome!

So what's the problem?

Like sales taxes, VATs are **very
regressive**

Burden falls heaviest on
lowest earners

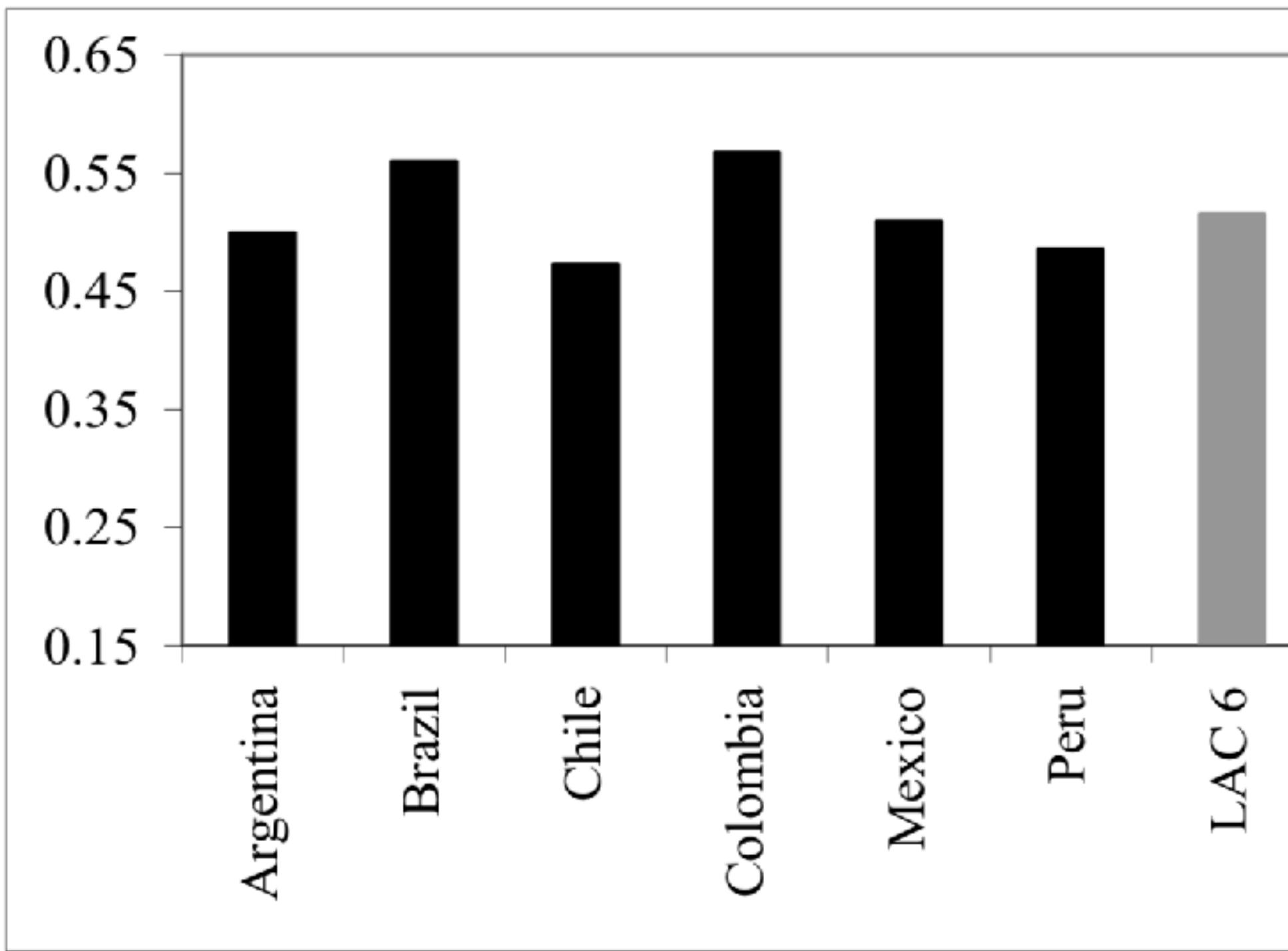
Brings us to next problem, which is that tax structures in LA are pretty regressive



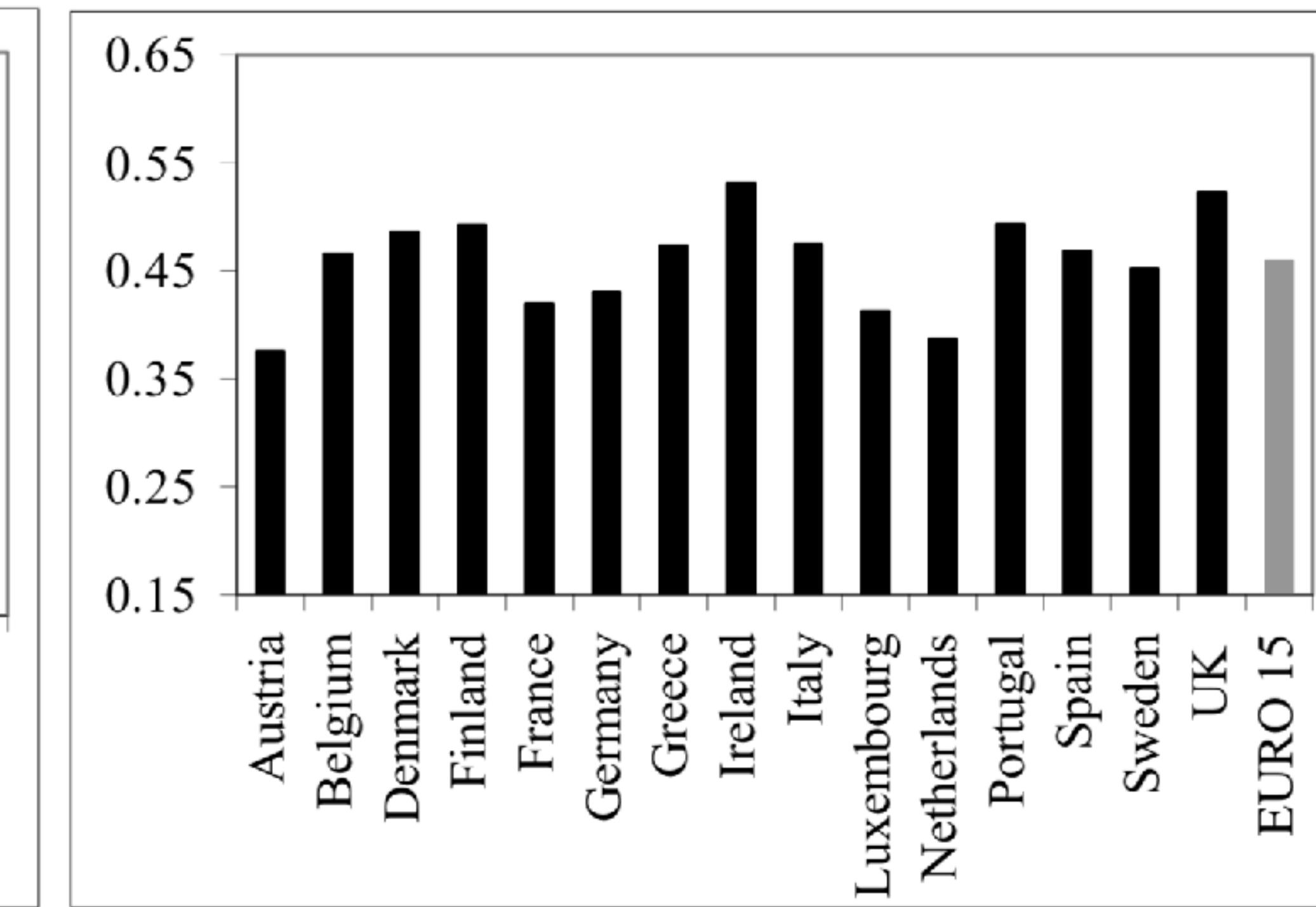
Check out post-tax Europe vs. LA...

...now look at *pre-tax* Europe vs. LA

Panel C. Latin America



Panel D. Europe



EU doesn't look so different from "most unequal region in the world"! Gap is post-tax!

Transfers (spending that benefits poor at expense of rich)

In LA, small and regressive

What are these transfers?
And why so regressive?

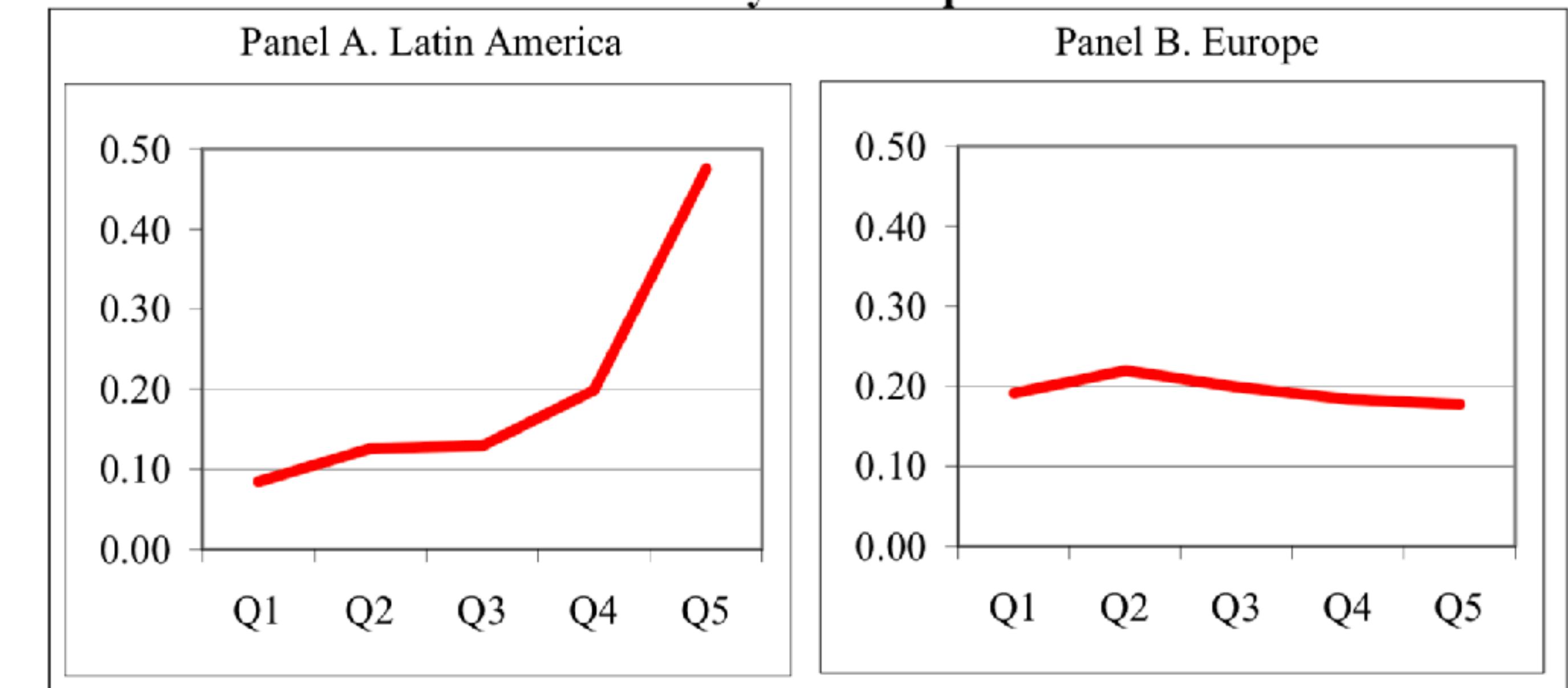
Pensions + unemployment
insurance = need **formal**
employment

Table 5. Transfers in Latin America and Europe (% of GDP)

	Argentina	Brazil	Chile	Colombia	Mexico	Peru	LAC6	Europe
Social Insurance	7.7	11.7	6.9	5.9	2.6	3.1	6.3	14.7
Social Assistance	1.5	1.4	0.7	0.6	1	0.5	1.0	1.6
Total Transfers	9.2	13.1	7.6	6.5	3.6	3.6	7.3	16.3

Source: Lindert et al. (2006)

Figure 10. Public transfers in Latin America and in Europe
Incidence by income quintile

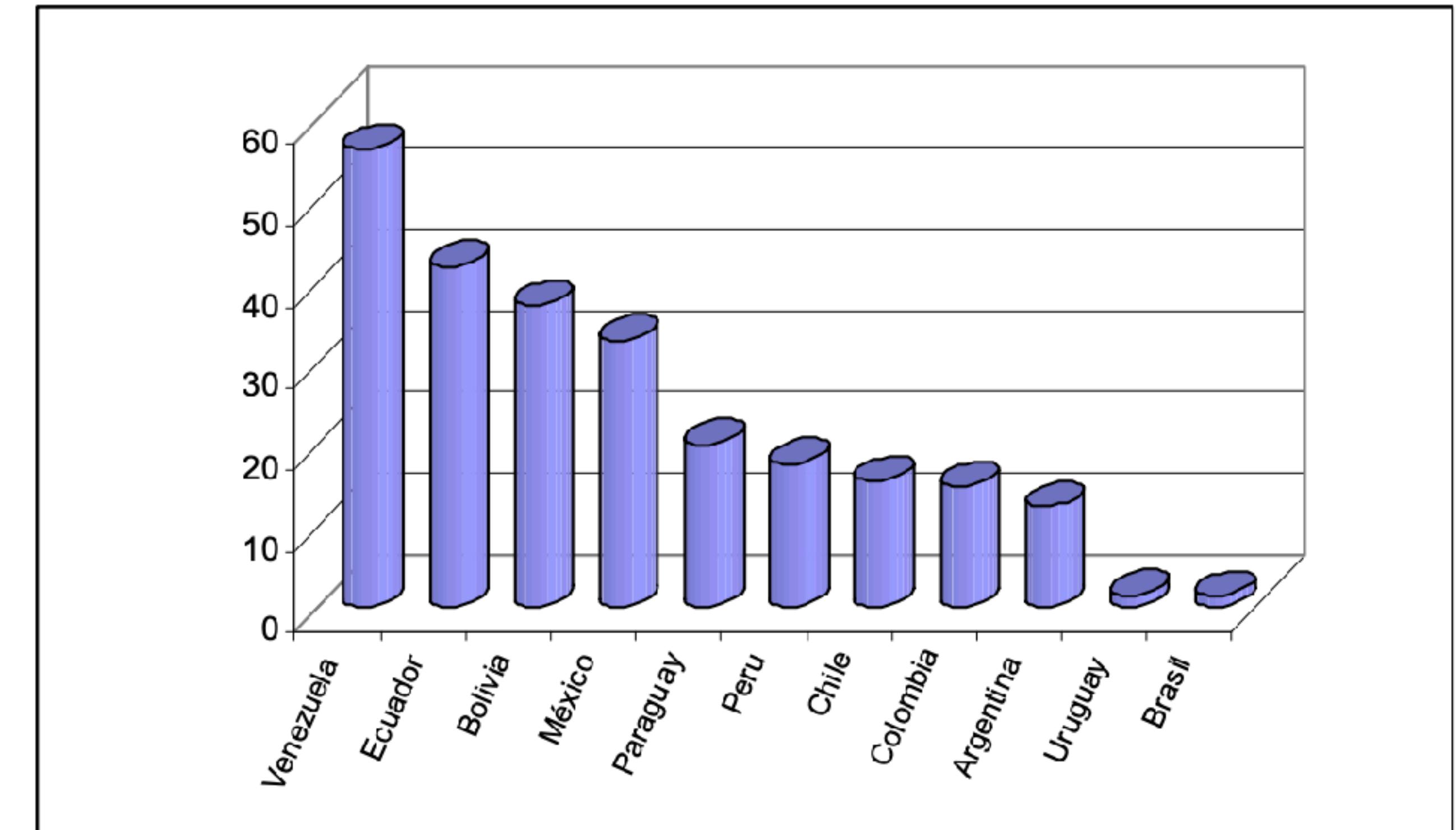


ALTERNATIVES?

To avoid the taxation headache, countries with valuable natural resources will tax them instead

But these are vulnerable to global market fluctuations and are **known for corruption**

Gráfico 1
Relevancia de los ingresos rentísticos (circa 2008*)
-en % de los ingresos corrientes del gobierno central-



Fuente: Ministerios de Hacienda nacionales

TAKEAWAYS

LA governments have little capacity to collect tax

Why? Low administrative capacity, informal economy, low tax productivity

Taxes + transfers are **regressive**: poorest (informal) often have least access

Efforts to improve state capacity

Decentralization

Participatory budgeting

“THE WEEDS” ON ASYLUM

<https://www.stitcher.com/show/voxs-the-weeds/episode/after-asylum-67269633>

What is border patrol doing now
than it wasn't doing before? Who's
job was it before?

Why do this? What's the tradeoff?

In some ways, the Weeds episode is
describing **decentralization** “in spirit”

Decentralization is a transfer of power
further down the chain of authority

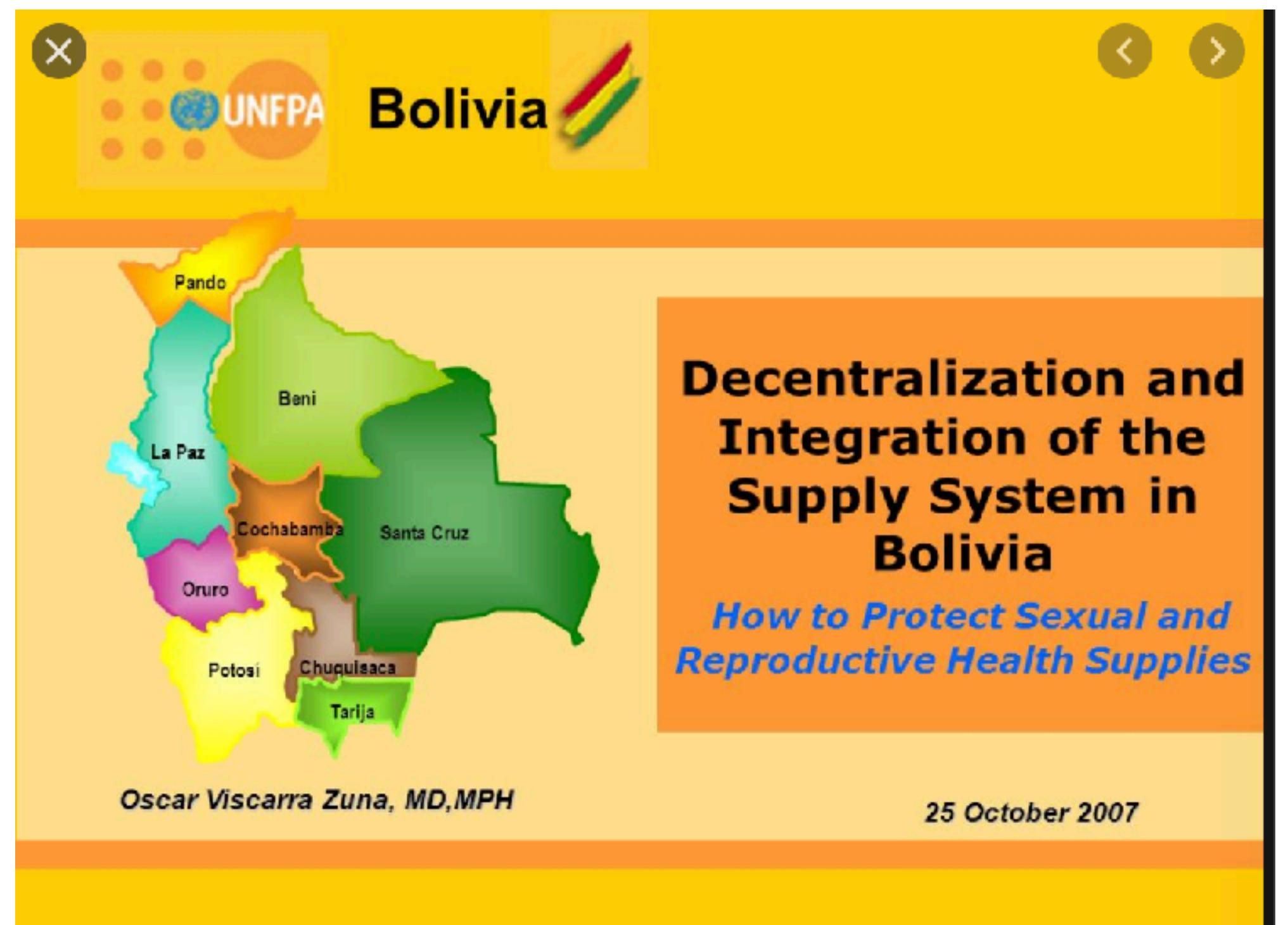
Federal → States

Federal/States → Cities

Decentralization reforms swept across developing world in 1980s and 1990s



~80% of countries with >5 million people undergo process



A presentation slide from UNFPA Bolivia. The top left features the UNFPA logo and the word "Bolivia" next to the Bolivian flag. The top right has navigation arrows. The middle section contains a map of Bolivia with its departments color-coded: Pando (orange), La Paz (light blue), Bari (light green), Cochabamba (brown), Santa Cruz (dark green), Oruro (purple), Potosí (yellow), Chuquisaca (pink), and Tarija (light yellow). Below the map is a title box with the text: "Decentralization and Integration of the Supply System in Bolivia" and "How to Protect Sexual and Reproductive Health Supplies". At the bottom left is the author's name, "Oscar Viscarra Zuna, MD, MPH", and at the bottom center is the date, "25 October 2007".



THE IDEA

Policymakers removed from needs/interests of citizens



If you could somehow give citizens more control over policy, wouldn't that improve governance?

Push for decentralization by historically marginalized social movements, indigenous groups seeking more voice in government



What forms does decentralization take?

Political

Election of previously appointed
offices (e.g., mayors)

Administrative

Assumption of federal
responsibilities (e.g., education)

Fiscal

Local budgetary control
(hold own budget)

Town A needs more education

Town B needs more water treatment

The same allotment of education and water treatment leaves both unhappy

Move policy levers closer to citizens to provide **tailored, more efficient public services**

Political =
The mayor

Admin. =
The local government

Fiscal =
The local budget

Does it actually work?

Political scientists have mostly soured
on **decentralization**

Decentralization can make **regional inequalities** more pronounced

At the limit, each jurisdiction does all tax collection and expenditures on behalf of residents

That means richer areas keep their own wealth, which hurts **transfers**

Richer cities subsidize national budgets

Table 1. Budget Transfers from Large Cities to Poorer Jurisdictions

Category	Abidjan 1984	Bangkok 1987	Casa- blanca 1982	São Paulo 1985	Paris 1984
Share of country population	18	14	12	12	18
<i>Share of national budget (percentage)</i>					
Contribution to budget	54	41	34	20	26
Gains (benefits) from budget	25	28	18	14	19
Gains (flow) from budget	34	35	21	9	21
Transfers (benefits)	25	13	16	6	7
Transfers (flow)	18	7	13	12	5
<i>Transfers (U.S. dollars)</i>					
Transfers (benefit) per capita	200	160	400	90	870
Transfers (flow) per capita	160	80	330	160	630
<i>Transfers (percentage of GDP)</i>					
Transfers (benefit)	5.3	2.5	6.5	7.4	1.7
Transfers (flow)	4.2	1.3	5.5	13.9	1.3

Source: Davezies 1989; Oliveira 1991; Davezies, Nicot, and Prud'homme 1984, 1987; Nicot and Letrung 1989.



Santa Cruz department in Bolivia
~30% of National GDP

Some attempts to secede!



WHY MIGHT IT NOT WORK?

Theory of decentralization rests on citizens:

- 1) being able to ID good performance
- 2) reward/punish that performance

Without this feedback mechanism, local elites might be able to capture **these new functions**

This process can generate **corruption**

All the problems common to federalism:

Unclear jurisdictions across local, national,
regional

Local bureaucrats might be lower quality

Uneven/arbitrary regulations across regions

The Impact of Recentralization on Public Services: A Difference-in-Differences Analysis of the Abolition of Elected Councils in Vietnam

EDMUND J. MALESKY *Duke University*

CUONG VIET NGUYEN *National Economics University*

ANH TRAN *Indiana University Bloomington*

Comparative political economy offers a wealth of hypotheses connecting decentralization to improved public service delivery. In recent years, influential formal and experimental work has begun to question the underlying theory and empirical analyses of previous findings. At the same time, many countries have grown dissatisfied with the results of their decentralization efforts and have begun to reverse them. Vietnam is particularly intriguing because of the unique way in which it designed its recentralization, piloting a removal of elected people's councils in 99 districts across the country and stratifying the selection by region, type of province, and urban versus rural setting. We take advantage of the opportunity provided by this quasi experiment to test the core hypotheses regarding the decision to shift administrative and fiscal authority to local governments. We find that recentralization significantly improved public service delivery in areas important to central policy-makers, especially in transportation, healthcare, and communications.

But then there's participatory budgeting...



An experiment in governance beginning in Porto
Alegre

NOW EVERYWHERE

Building the Budget from Zero: Online Participatory Budgeting in San José, CA

Posted on February 22, 2016 at 5:05 pm.

Written by [Luke Hohmann](#)

Mayor Sam Liccardo and the San José City Council, in partnership with the [Every Voice Engaged Foundation](#) and [Conteneo Inc.](#), invite San José residents to [participate online](#) in a citywide participatory budgeting event during the week of February 22, 2016.

The hour-long online "zero-based" budgeting sessions will provide residents with an opportunity to get involved in their government and community and impact the city budget.

How to participate

Residents may participate in collaborative forums with their neighbors from a laptop or

Community Budget Priority Setting
Building the Budget from Zero

WHAT IS PARTICIPATORY BUDGETING

Participatory Budgeting can be described as "Local People deciding how to allocate part of a public budget."

[FIND OUT MORE](#)

THE ATLANTIC SELECTS

The 'Gateway Drug to Democracy'

Nov 07, 2018 | 820 videos

Video by [Jay Arthur Sterrenberg](#)

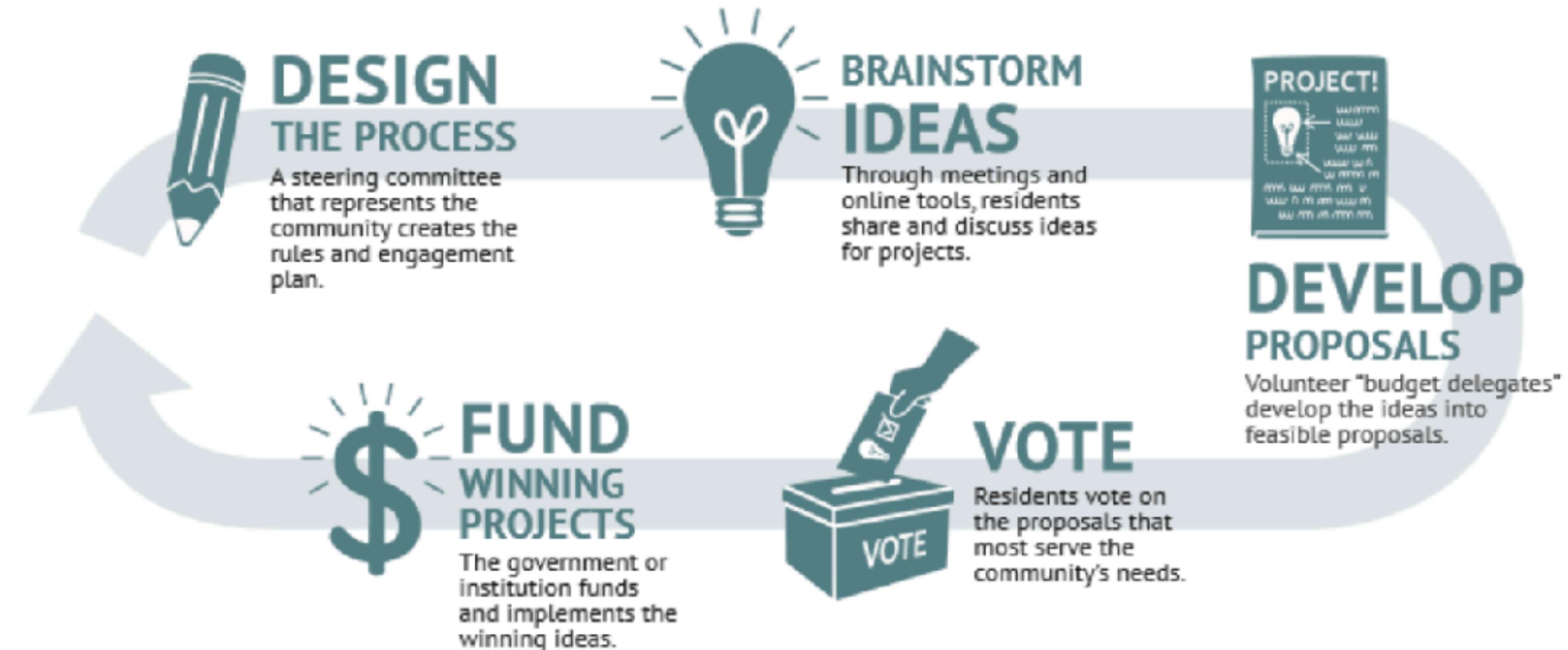
The fastest way to reveal a nation's priorities is to take a look at its budget. Where money is allocated, improvements and expansions are made; where costs are cut, institutions and policies wither. In America and other similar democracies, political candidates campaign on budget promises, but it can be difficult to



Allocate portion of city budget to public input

People meet, debate, decide how to allocate that budget

Constrained choices:
Ranking of area-specific spending (e.g., sidewalks)
Ranking of universal spending (e.g., clean beach)



Steering committees are elected, so question of who ends up in them and how is very important!

NATIONSWELL 2017 ALLSTARS

PARTICIPATORY BUDGETING GOES HIGH-TECH IN THE BIG EASY

Bring the power of collaborative games to your community!

The [Every Voice Engaged Foundation](#) is working to transform communities using the power of Innovation Games. Donate. Request an event, become a facilitator, volunteer, donate, help us break the impasse and bring positive change to our governments and communities. [\[Join in\]](#)



City of San Jose *Budget Games*

On January 29th, 2011, we made history by applying our proven methods to Public Sector problems, working with the city of San Jose, CA, to run the [first-ever Budget Games](#). The games brought together a diverse and motivated group of over 100 engaged citizens who provided feedback to the Mayor's Office regarding their budget priorities. We [designed](#) and produced all aspects of the event, including recruiting more than 30 of our [trained Innovation Games facilitators](#) to manage the games. The game was a huge success and San Jose Mayor Chuck Reed was able to act on many of the budget items citizens chose.

Thanks to the success of the 2011 games, we have produced a second and third [Budget Games](#) in 2012 and 2013 for the City of San Jose, CA, and helped launch the [Every Voice Engaged Foundation](#) to bring Budget Games and Community Games to the communities across the U.S. The Budget Games went global in 2013 with the announcement that the City of Kortrijk, Belgium will be using Budget Games as part of its citizen engagement project Kortrijk Speaks.

The Effects of Participatory Budgeting on Municipal Expenditures and Infant Mortality in Brazil

SÓNIA GONÇALVES*
King's College London, UK

Summary. — This paper investigates whether the use of participatory budgeting in Brazilian municipalities during 1990–2004 affected the pattern of municipal expenditures and had any impact on living conditions. It shows that municipalities using participatory budgeting favored an allocation of public expenditures that closely matched popular preferences and channeled a larger fraction of their budgets to investments in sanitation and health services. This change is accompanied by a reduction in infant mortality rates. This suggests that promoting a more direct interaction between service users and elected officials in budgetary policy can affect both how local resources are spent and living standard outcomes.

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Participatory budgeting is much narrower than decentralization

Maybe the answer is not wholesale decentralization, but decentralization in some areas?

CENTRALIZE OR DECENTRALIZE?

Building of highways, roads

Street cleaning

Public education