Final report

ROUND-TABLE ON FISCAL POLICY, GROWTH AND INEQUALITY

September 7 and 8, 2011
Andean Community of Nations
Lima, Peru

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1. Overview

In the context of an active civil society process of participation and organisation in matters regarding fiscal justice, Latindadd, in collaboration with the Central American Institute for Fiscal Studies (ICEFI), Poder Ciudadano, Christian Aid, Tax Justice Network and the Hemispheric Working Group on Trade - Finance Linkages organized the round-table on “Fiscal policy, growth and inequality” on September 7 and 8, in Lima, Peru.

This event brought together fifty representatives of civil society organizations at a national, regional and international level and six governments of the region for them discuss and share experiences on the role of fiscal policy regarding the growth and the fight against inequality, the challenged posed by the new global economic and financial reality (as well as the regional juncture), the proposals made by the civil society and the possible spaces for dialogue between the civil society and government representatives.

The discussion was organized into six groups in line with the following themes:

- Fiscal policy in Latin America in the context of the global crisis
- Fiscal policy and capital market regulation
- Fiscal policy and financial flows
- Tax havens: tax evasion and capital flight
- Corruption and money laundering
- Civil society to government dialogue on fiscal policy and taxation

The causes and consequences of the global economic and financial crisis render it essential to conduct an in-depth debate, one that reaches beyond the mere diagnosis and description of situations. In Latin America we have a long road ahead in search of the type of development policy that meets the needs of the region. The emphasis of this process must be placed on growth that is based on equity, and fiscal policy is the most suitable instrument to achieve this.

The spirit of Latindadd and the organizations calling this round-table on fiscal policy, growth and inequality has been generating a suitable framework for analysis and making proposals. This report seeks to reveal the debates that took place during these two days of intense work efforts and share the main topics and concerns that were dealt with, and put forward by both the civil society organizations and the governments participating.

Lima, November 30, 2011.

2. Introduction: in search of a space for fiscal issues

Given the current conjuncture and after the recurrent crises sustained, Latin America must face the various challenges in a world that is now undergoing a revision of models – in different but closely related aspects such as economics, finances, trade, energy and environmental management, to mention but a few. According to Latindadd coordinator Rómulo Torres, one of these challenges is the promotion of substantial changes within the regional and global financial system and architecture, since the current model hinders domestic and sovereign decision-making, control of resources management. This may – when such processes lack transparency – upset the balance of national economies and prevent due exercise and enjoyment of citizens' rights.

Latindadd firmly believes that in order to carry on this work it is crucial for Latin America to:

- **a.** design a new regional financial architecture that allows regulation by both institutions and public policy;
- **b.** move forward toward a sovereign, democratic and responsible public financing model which fosters fairer ways of debt management – thus avoiding sub-ordinations and disregard for citizen rights – while strengthening development cooperation that enables sovereign decision-making; and
- **c.** promote a different "tax contract", within this new public financing model, as the only means to ensure that the results of economic and financial activity will benefit us all.

The fiscal problem is not a purely technical matter but it also has a fundamental political aspect, since it determines the kind of society we intend to create. Alberto Adrianzén, vice-president of the Andean Parliament, claims that the need for this political function of fiscal regulation – as a device for correcting inequality issues generated by the market, beyond the mere role as a tax-collector. This is clearly revealed by the following piece of information: "after tax and transfers, income inequality in Latin America, as measured by Gini index, is reduced by hardly 2.5 percentage points – from 52.3% to 49.6% – whereas in OECD countries it is reduced by nearly 15 percentage points – from 45.9% to 31.1%".

However, for Adrianzén, the creation of a new fiscal framework in Latin America is also hindered by historical as well as cultural aspects that might render it difficult to put a new model into practice:

- the "culture of inequality", based on the idea that there exist certain people or groups of people that, for different reasons, do not "need" to improve their income because they are used to getting by on little, and
- the "culture of economic informality", which goes beyond criminal activities, one that socially tolerates irregularity based on the premises that the state does not "deserve" being paid taxes and is based on the belief that "if the rich evade taxes, why shouldn't the poor?"

In addition, neoliberal models have ever more accentuated historical inequality in Latin America to the point that it became the world's most unequal region. Despite this, the continent is experiencing an exceptional political shift in which, unlike a few decades before, has led to the political map being dominated by inclusive democracies that have allowed the rise of new majorities and the displacement of former dominant elites. Now this situation needs to be embedded by means of a new social contract.

This new social contract must create the necessary space for an -also new- culture of taxation, in which transparency and accountability on the part of representatives are a priority. In the process of elaborating such an agreement the decisive factor shall be – as Bruno Gurtner, Chairperson of Tax Justice Network said – the "influence of citizens on the democratic oversight" of processes, so as to reduce the power of capital-owners and markets in the pursuit of fiscal policies to their own advantage. That is why civil society organizations and networks cannot fail to play an active role in this construction through popular education and awareness raising, research and mobilisation, but also through responsible dialogue with the different actors and stakeholders involved.

3. Fiscal policy in latin america in the context of the global crisis

With the coming to power of some governments that might be regarded as "progressive", the historic situation of inequality seems to be showing signs of reversal in several Latin American countries. In an attempt to mend the damage made to the social fabric by neoliberal policies, these governments have aimed at the redistribution of income and wealth so that the economic growth will translate into greater welfare for the poorest social strata.

Economic growth in itself, as Claire Kumar (Christian Aid) explains, is not strictly-speaking, directly or obviously related to inequity or poverty reduction. For a long time, however, the main goal of public policy has been to promote economic growth. This approach was flawed in several ways. In some cases, the growth-oriented policies themselves have failed; in others, the growth attained has not resulted in development, let alone to an improved quality of life. Furthermore, even in the few cases where economic growth did foster a certain degree of development, Kumar wonders how greater such development would have been if the primary strategy had been giving it priority over mere growth.

Countries which face high levels of inequality, such as some in Latin America, the impact of economic growth on poverty reduction is rather low. A study carried out by Christian Aid in 2008 and published in Great Britain, Getting growth right[1], showed that between 1990 and 2001, for every USD 100 of global growth per capita, only USD 0.60 contributed to poverty reduction. Christian Aid claims in the document that "it is necessary to have a realistic vision of the potential and limitations of economic growth. Policy-makers must not encourage growth for the sake of growth itself, but maximize the benefits of growth for development. In order not to waste opportunities for development, we have to take the right path to growth".

Fiscal policy in general -and tax policy in particular- is the way some governments have already chosen towards a more equitable path. A good example of this is the taxes on exports in Argentina. According to Horacio Rovelli, from the Argentine Ministry of Pub-

1. Available on: www.christianaid.org.uk/Images/getting_growth_right.pdf

lic Finance, the State takes advantage of international grain prices and the "extraordinary profits" produced by exports – soybeans, in particular – for redistributing wealth in Argentina. Soy exports are levied with a 35% tax rate, which generates considerable revenues earmarked to cover the cost of debt, on the one hand, and, on the other, to support the rest of the industry in the form of subsidies, mainly energy-related. This redistribution, in turn, allows the strengthening of other industries such as aluminium, steel, or the automotive industry.

In terms of revenues, as per ECLAC figures published in May 2010, the average tax contribution in the region is at 18 per cent of GDP. The only exceptions have been Brazil and, more recently, Argentina (see Table 1[2]). In the latter, this contribution amounts to 30% of GDP, of which 9 per cent corresponds to income tax and export duties added together. Nevertheless, although revenues have increased since the 1990s, they are still not enough to meet the needs for financing of government expenditures. Increases have accrued as a result of the professionalization of tax administrations, curbing on corruption and tax evasion. Latin America is still far from OECD levels of tax contributions, where average tax contribution, as percentage of GDP, was nearly twice as much as the Latin American Region in 2007.

Table 1.

LATIN AMERICA: TAX REVENUE OF CENTRAL GOVERNMENT, INCLUDING SOCIAL SECURITY CONTRIBUTIONS

(Percentages of GDP)

	1990	2000	2008
Argentina [a]	16.0	21.5	30.6
Bolivia (Plurinational State of) [a]	9.3	17.9	21.7
Brazil [a]	26.4	30.4	35.5
Chile [a]	15.5	18.9	20.9
Colombia [a,b]	9.5	14.9	18.4
Costa Rica [a]	16.9	18.9	23.1
Cuba	...	27.5	25.2
Ecuador	10.1	11.6	16.5
El Salvador	10.5	12.4	14.6
Guatemala	7.6	10.9	11.6
Haiti	7.3	7.9	9.5
Honduras	12.9	14.3	15.9
Mexico	11.4	11.0	9.4
Nicaragua	9.0	17.5	21.7
Panama	14.7	16.0	16.5
Paraguay	9.9	12.0	13.7
Peru	11.7	14.1	17.4
Dominican Republic	7.1	11.3	15.0
Uruguay	21.2	22.5	23.3
Venezuela (Bolivarian Republic of)	18.7	13.6	14.2
Average for Latin America (excluding Cuba)	12.9	15.7	18.4
Average for Latin America	12.9	16.3	18.7

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

[a] General government.

[b] The 2008 figure corresponds to 2007.

2. ECLAC. La hora de la igualdad: Brechas por cerrar, caminos por abrir. May 2010. Available on: www.eclac.org

Oscar Ugarteche, a researcher from the UNAM (Autonomous National University of Mexico) and Latindadd, claims that financial reforms so far had been designed to increase wealth through strengthening the financial sector – a favourite topic for theoretical economists, not only in Latin America but worldwide. Now that this wealth has effectively been increased, the tax structure must be modified so that revenue collection to become progressive.

It is worth pointing out that, nowadays, two thirds of the tax contribution falls to consumption tax and other indirect taxes, and only one third to direct taxation (personal income tax and corporate income tax). That is why, according to ECLAC itself, "it is not surprising that revenue distribution after tax is even more inequitable than primary distribution". Therefore, it is necessary that in the future direct taxes – like income tax – would have greater weight in total revenue and indirect taxes – highly regressive, like the VAT – would be reduced. Moreover, effective taxes must be levied on the mining sector – so that the extraction of natural resources would really contribute to developing national economies. Furthermore taxes should be increased on the financial sector – in order to fight speculation.

3.1. Integration processes and fiscal policies

The degree of progress of integration processes differs in Latin American subregions. In South America there are several ongoing initiatives: the Andean Community of Nations (CAN)[3], the Southern Common Market (MERCOSUR)[4] and, more recently, the Union of South American Nations (UNASUR)[5]. In Central America, the Central American Integration System (SICA)[6] is officially under way. This region's relations with South America have been historically scarce, due to Mexico's increased shift to looking northwards and the subsequent development of strong direct connections with the United States and Europe. Mexico is currently directing its full attention to the US – while keeping a residual trade relation with South America – and this has left Central America somewhat isolated.

The situation of Central America before the economic and financial crisis that broke out in 2008, according to ICEFI researcher Ricardo Barrientos, showed certain stability.

3. Bolivia, Colombia, Ecuador and Peru.
4. Argentina, Brazil, Paraguay and Uruguay.
5. Argentina, Brazil, Bolivia, Colombia, Chile, Ecuador, Guyana, Paraguay, Peru, Suriname, Uruguay and Venezuela.
6. Belize, Costa Rica, El Salvador, Guatemala, Honduras, Nicaragua and Panama.

Several countries registered decreasing fiscal deficits (in some cases even surpluses). Such results have been possible through sustained growth, the pursuit of public spending oversight policies, and some tax reforms. Later on, as a result of the region's strong dependence on the economies from other parts of the world, the global financial collapse had two immediate effects. On the one hand, economic activity fell sharply as from the first few months of 2008; and on the other, the rapid increase of unemployment of persons of Hispanic origin in the U.S. (13%, in line with figures of the Bureau of Labour Statistics). This has led to dramatically reduced family remittances towards Central America.

The impact of the crisis on the region's fiscal revenues was also immediate. Average tax contribution, which was growing at a rate of 4% in 2007, dropped by 7% in 2008-2009. According to Barrientos, the main causes for the fiscal impact on the region were the reduction in domestic consumption (main component of GDP), the drop in revenues of export duties and a weak tax system unable to react in sufficient time when faced with the magnitude of the crisis. In this context Central America is increasingly now disconnected from its former partners of the North, and rather seems to be commencing to approach the South.

Meanwhile, in South America there is an intra-regional trade of manufactured products that is in full growth, and Mexico does have influence with this respect. As regards to this, Ugarteche points out that even though Mexico's trade with South America may not be relevant for themselves, the total of Mexican finished products marketed in the South American region is greater than those of Argentina's and Brazil's put together. This growth in the trade of finished products is not easily noticeable due to the figures resulting from the exceptional demand of raw materials from Mexico as well as those from the maquilas trade between Mexico and the US.

Ugarteche explains that the increase in intra-regional trade causes relative exchange-rate stability. With the fall of the dollar, Latin American currencies appreciate in relation to it and – with the exception of Argentina and Venezuela who have maintained certain stability. The current situation allows trading in domestic currencies but, for it to continue and further develop, the aim must be on converging fiscal policies, with similar deficit and tax contributions in the different countries – for instance, with similar value added taxes, which do not distort trade. In order to attain certain coordination in fiscal policies governments, in turn, must maintain strength, and be well able to keep their finances under control.

As regards supra-national organisations, Ugarteche believes that CAN (Andean Community of Nations) is the only example of an integration process in which countries relinquish a part of their sovereignty and decision-making powers to standardize the policies of members-countries. Mercosur, meanwhile, is not much more than an economic integration treaty where only two of the four parties – Argentina and Brazil – make bilateral agreements and in which the smaller economies of Paraguay and Uruguay have little to contribute.

Nowadays, the political and economic context is favourable to integration within the region. UNASUR should incorporate the positive aspects of CAN and Mercosur experiences and strengthen the internal market of the regional, this implies revitalizing the original principle behind the first attempts at economic integration in Central America, such as the General Treaty on Central American Economic Integration signed in 1960.

4. Fiscal policiy and capital market regulation

Historically, the economic structure of Latin American countries have shown some features in common: concentration of wealth, hegemony of certain political and economic groups in power, systematic exclusion of large sectors of society in the processes of redistribution policies and the instalment of policies that have privileged capital over work. Latin America – just like South-east Asia and Africa – is currently experiencing a growth momentum, considering the macroeconomic indicators. That is to say, despite the crisis, countries in the region have experienced economic growth and the crisis has had much less impact on them than on Central American countries. Nevertheless, as Roberto Bissio points out, indicators measuring social development and progress towards the Millennium Development Goals, the Basic Capabilities Index (BCI)[7] developed by Social Watch, among others, shows that progress in terms of social indicators has slowed down as from 2000.

Therefore, if economic indicators improve while social development indicators worsen, it seems quite clear that the flaw lies with the way in which the new wealth is being transferred to society as a whole. Fiscal policies are solely accountable for this situation and, within them we include tax policies. In spite of the fact that, Bissio says, the notion of "he who is better off should be made to pay more" is nothing new – since it appears in texts as ancient as the Bible – its validity and putting into practice continues to find resistance, in particular, in the most inequitable countries. Nor is wealth concentration and tax evasion a new phenomenon but, over the past 20 years, it has soared to levels that had never been recorded before.

4.1. Problem of free movement of capital

Tax systems are currently facing two serious problems, and these are tax evasion and the free movement of capital, protected by a legal structure that prevents tax collec-

7. The BCI is an alternative index to the United Nations Human Development Index (HDI) – since it is used to assess the actual "starting conditions" of people's lives but does not use income as an indicator. Instead, it is based on three other indicators: percentage of children remaining in the school system up to the fifth grade, mortality among children under five years old, and percentage of deliveries attended by skilled health personnel. Thus the index is not affected by differences in purchasing power – of income measured in USD – in different regions.

tion when great amounts of wealth is involved. Such freedom of movement fosters great tax injustice, since it enables capital-holders to resort to a very simple threat: "if you make me pay taxes, I'll go elsewhere".

This sort of blackmail is often based on the fear of governments rather than on the actual intentions of investors. Fear gets to the public through the media, which reproduces the statements of politicians, and ruin all attempts to create greater awareness about taxes. Bissio illustrated this situation by telling the case of a cellulose pulp mill set up in Uruguay by Finnish UPM-Kymmene Corporation. This company is fully exempt from taxes for forty years – with a useful life estimated in thirty-five years. When civil society organizations in Finland confronted the company and challenged the one-sided conditions they were imposing on a country with urgent need for foreign investment, the company replied in these terms: "we have not imposed any conditions, we intended to make the investment one way or the other; it was the Government of Uruguay that offered us the exemptions".

That is because the interest in attracting investments has given rise to a tax-rate bidding war. Tax exemptions on private investment and tax stability agreements are used to attract capital, although several studies – a recent one by Global Emergency Group consulting company, among others – have shown that companies' decision to invest in a certain country goes far beyond reduced tax rates. Likewise, this competition has an enabling legal framework, through free trade and investment protection treaties that prevent restrictions on foreign trade and grant foreign investment preferential treatment.

For Katiuska King, at the time minister of Economic Policy Coordination in Ecuador, it is necessary to adequately regulate the substantial capital flow entering the region – often due to the continued crisis in the developed countries – which can be as detrimental for the economies attracting flight capital. The aggressiveness of capital movements formerly known as "swallow capital" has increased in such an alarming way that it is now being called "vulture capital". The current strategy is aiming at cost-effectiveness even in the food production market, which jeopardizes food sovereignty in the case of certain countries.

As regards this, countries in the region have adopted different strategies such as:

- devaluations,
- management of interest rates for foreign currency investments,
- creation of stabilization funds,

- minimum reserve requirements,
- setting-up of statutory requirements regarding minimum permanence for foreign investments,
- restrictions on off-shore operations in local currency, and
- implementation of direct oversight and approval rights.

However, countries have failed in two aspects: with regards to the analysis of which of these strategies are most suitable, and the coordination at the time of adoption.

According to King, it is also crucial to impose a Financial Transaction Tax (FTT) at a regional and global level. The importance of this measure has already been acknowledged, for instance, by the European Union and some G20 member countries.

Ecuador supports the integration-oriented vision of initiatives like UNASUR, the Bank of the South, and the Unitary System for Regional Compensatory Payments, as indispensable tools to face the crisis in its multiple forms, while acknowledging that the degrees of acceptance differ from country to country and for each one of them. King underlines the creation of the South American Council of Economy and Finances, at the UNASUR meeting, in August 2011, in Buenos Aires, Argentina.

At this meeting working groups were established that will be working on three aspects:

- joint management of reserves, to avoid the vulnerability involved in maintaining reserves out of the region and enable the circulation of surplus within the region,
- strengthening of production and intra-regional trade; and
- setting of mechanisms – currency swaps, for instance – to trade in local currencies within the region.

The debates on fiscal policies coordination and the adoption of FTT ought to take the importance of these work focal points into account.

With the exception of G20, no international organization has included capital controls on their agenda so far. Latin America is represented by Argentina, Brazil and Mexico within this group and, therefore, one of the goals of civil society in the region should be to put pressure on their representatives so that the other countries in the region do not become mere spectators and recipients of decisions made by the biggest G20 member countries.

4.2. Challenges facing Ecuador

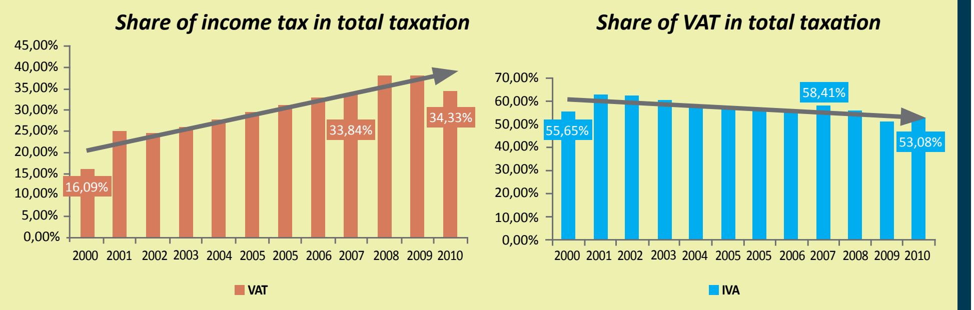
Ecuador has had no exchange rate policy since 2000, when they decided to adopt the US dollar as legal tender in order to weather the financial continued crisis by the country in 1999. According to King, dollarization proved beneficial to the financial system but greatly detrimental to depositors.

In 2006, the Ecuadorian Government initiated a series of reforms that, under a new Constitution voted by the constituency, attempt to place the citizen as the greatest beneficiary of every national policy, on the basis that the market is not the best manner to allocate resources. This is an attempt at reactivating the process of public financial planning, which had been left aside for its association with communist regimes, through the strengthening of institutions in charge of managing public investment, among other things.

One of the axes of action of this fiscal reorganization is the strengthening of the state itself in order to make it more effective for resource distribution and provision of public services. Another is the use of tax policies to encourage private investment, through incentives, and move forward aiming to a more progressive system. This involves the gradual replacement of indirect taxes with direct taxes, based on the principle: “the higher the earnings, the higher the tax” (see Chart 1). and the progressive exemption of taxes on certain products of high consumption among the lowest economic strata in society.

Chart 1.
Evolution of income tax participation in tax collection

SPNF income and expenses



During the last decade, it has been evident a greater ‘progressivity’ of the taxes.
IT increased its share from 16.09% to 34.33% in total taxation while VAT reduced its share from 55.65% to 53.08% between 2000 and 2010.

Source: Servicio de Rentas Internas

This new social and economic vision also incorporates the popular and supportive sector, made up, among others, of cooperative enterprises in the financial sector – savings and loan associations, community funds, etc. – and producers' associations, which require preferential tax treatment.

The Ecuadorian fiscal policy also takes into account the productive sectors of the economy. Ecuador, like many countries in the region, is a primary exporter and has almost no value-added exports. This means few products, few markets and few export agents, in a system that has a low density of producers. The strategic plan that intends to modify this current reality is in its first phase, in which the aim is a strategic replacement of imports to recover certain local productions and invest in increasing skills and providing training.

5. Fiscal policy and financial flows

5.1. South America according to ECLAC

In the opinion of Martín Abeles (ECLAC), one of the greatest concerns of South American countries currently, is the tendency to "return to primary production" of their economies and its consequences on tackling inequality. This is the result of the combination of two external factors: the high international prices of raw materials from the region, and the impact of monetary policies based on excessive money supply in Northern countries. These two aspects cause an exchange rate pressure which endangers the non-traditional economic sectors in the region.

Unlike Central America and the Caribbean, where the fiscal issue is the main concern, what is at stake in South America is the future of the productive economic structure in the medium term. Abeles recalls that, with some very precise exceptions, there are no examples of non-diversified economies showing a good distribution of the sources of revenue. The degree of complexity and productive diversification is, therefore, the only valid device in achieving greater equity in the medium and long term.

For ECLAC, the creation of a macro-economic order that is conducive for development is highly necessary, one that generates incentives and facilitates the growth of a pioneer industry, that is to say: one that does not only invest in preserving "what we have", but also aims to create and develop knowledge and new technologies. In this regard, fiscal policies and policies that provide technological and industrial support play a fundamental role when it comes to deciding what sectors must be given priority.

5.2. Investment seen through the microscope of speculation

Aldo Caliari, from the US Center of Concern, claims the reforms implemented in countries of the region in the 1980s and 1990s have determined the countries to measure the success of the new policies as per the increase in exports, regardless of the added value generated by those exports. This measurement also hinders the observation of drawbacks or benefits the countries have at times of major trade imbalances, like those occurred after the recent global crisis.

In this context, Caliari explains, the increases in trade balances are not reflected on current accounts due to, for instance, repatriations to companies that bring their profit back into their country of residence. Nowadays, financial speculation increasingly affects trade flows, distorting "market signals" which, in normal conditions, would serve to indicate the destination of potential investments. Therefore, even though companies may decide to reinvest their profit in the same country where they generated it, they usually do so by following such a purely speculative and distorted logic.

Fiscal policy is the only instrument that the countries retain to mitigate the effects of speculation and volatility. This device therefore ought to, among other things:

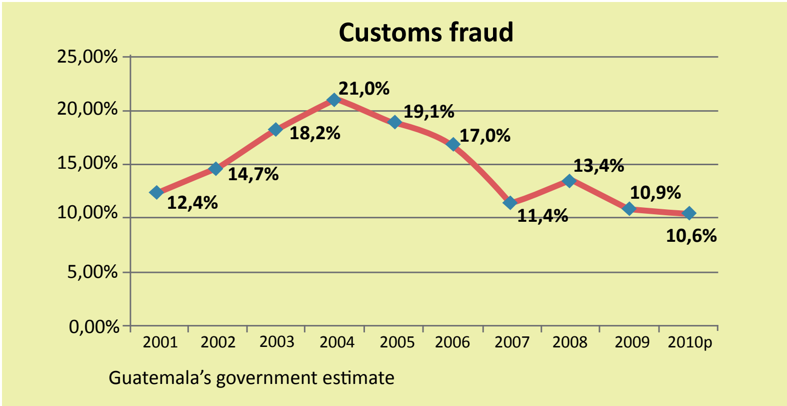
- Modify productive patterns, by supporting those sectors that are naturally more redistributive,
- capture the income resulting from primary resources, even by nationalizing the most strategic ones, and
- discourage financial speculation, applying FTT worldwide.

It is worth saying that although governments may have no direct influence on capital and the free movement of same, they can indeed correct the distortions by changing the parameters of microscope through which investors are looking at investment possibilities.

5.3. Problem of smuggling in Guatemala

According to Abelardo Medina, from the Guatemalan Superintendence of the Tax Administration, the gravest tax-related issues faced by his country are not technical but political. The most significant evasion occurs through "documented smuggling", which is movement of goods through customs points without paying any duties, rather than the sort of smuggling that evades all customs' controls. Even though this situation has improved, in 2010 the country experienced a 10 per cent loss in customs tax revenue (see Chart 2). In this context, and under export promotion policies, goods and services equivalent to 10.2% of GDP leave the country untaxed. In addition, a series of additional incentives and exemptions – such as income tax, which exporters do not pay – amount to another 0.4% of GDP.

Chart 2.
Estimated percentage of revenues lost as a result of customs duty fraud/smuggling in Guatemala



Moreover, with the argument of not levying taxes on goods destined to foreign countries, exporters are often reimbursed the VAT paid in previous stages of production, amounting to 0.7% of GDP. Another challenge for tax authorities is, therefore, to identify shell company chains that request unjustified tax credits.

Given that there is an absence of a national customs law, Guatemala is unable to put an end to smuggling since, although regional agreements clearly define these as offences, penalties subsequently depend on national governments. The bills for a national customs law that have been submitted so far have have never been passed by parliament. Another problem is access information in the banking system. Medina says even the constitution was drafted to benefit taxpayers over the state, which facilitates tax evasion and avoidance and hinders work of the tax administration.

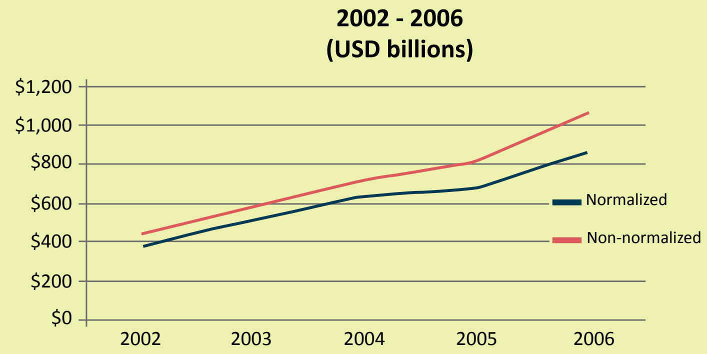
Also, there is a complete lack of agreements concerning tax policy coordination with bordering countries, and thus smuggling is widespread and strongly incentivised by the differences in the prices of certain products along the 1,200 km of border with Mexico, with only four legal crossings out of over 50 informal ones.   One of the most common examples being fuel smuggled from Mexico to Guatemala, and sugar from Guatemala to Mexico. The process of agreeing on a customs union treaty with other countries of the region, which Guatemala has been promoting since 1999 and might help to solve some of these problems, has not experienced any significant progress.

6. Tax havens: tax evasion and illicit capital flight

According to 2011 figures presented by the United Nations Development Programme (UNDP), the net difference between capital inflow – basically remittances and investment – and outflow – for debt service and capital flight – in less developed countries is USD 197 billion in favour of the capital outflow.

Furthermore, according to Global Financial Integrity (GFI)[8], a Washington-based group of experts, developing countries lost an average USD 850 billion to USD 1 trillion per year in 2002-2006 due to illicit financial flows (see Chart 3). Estimates also indicate that the capital flight curve continued to grow (at a 12% annual rate) despite the crisis.

Chart 3.
Evolution of illicit financial flows from developing countries



Source: Global Financial Integrity, "Illicit Financial Flows from Developing Countries: 2002-2006" December 2008.

8. Illicit Financial Flows from Developing Countries: 2002-2006. December 2008. Available on: http://www.gfip.org/storage/gfip/documents/executive%20-%20final%20version%2005-14-09.pdf

Marta Ruiz, from the European Network on Debt and Development (Eurodad), explains that the greatest part of illicit financial flows does not result from corruption or criminal activities, unlike reports from government authorities in Northern countries. Actually, two thirds are connected with business flows, that is to say, tax evasion and avoidance by multinational companies operating in the South. According to research carried out by Christian Aid[9], developing countries experienced a loss of USD 160 billion every year due to unpaid taxes through faked invoices and abusive use of transfer prices between the subsidiaries of the same company. This amount is equivalent to 1.5 times the budget that developed countries earmarked to development aid in 2007.

The problem of tax evasion, says Mauro Andino, from the Ecuadorian Internal Revenue Service, is closely related to weak tax administrations, due to the lack of resources of governments and the difficulties they experience in accessing reliable information concerning the activities of multinational companies. This is caused by the lack of international cooperation in fiscal matters. In some cases the large multinational corporations have an economic weight equivalent to the GDP of the countries where they operate, which hinders the bargaining power of national governments.

At the beginning of the crisis, the G20 incorporated in their agenda the issue of tax havens – which later on were to be known as "non-cooperative jurisdictions" – specifically at the time of the 2009 London Summit declaration. However, illicit capital flight has never been directly addressed. In the opinion of Jorge Gaggero, from CEFID-AR and Tax Justice Network, the statement has important implications, since it only mentions the instrument but not the offence itself. It is crucial for Latin America to include the item of tax havens on the agenda of integration bodies and for them to keep a common register of tax havens, an alternative to OCDE's list. A good starting point, says Gaggero, would be that UNASUR member countries made common cause in the G20 regarding this matter.

6.1. How multinational companies dodge paying taxes?

There are different methods, both legal and illegal, through which multinational companies manage to avoid and evade paying taxes.

9. Death and taxes: the true toll of tax dodging. Christian Aid. May 2008. Available on: http://www.christianaid.org.uk/images/deathandtaxes.pdf

a. Tax avoidance: legal practices

As Marta Ruiz explains, historically multinational companies for tax or other regulatory purposes have set up subsidiaries in every country they operate. They also set up non-operative subsidiaries for administrative, legal or tax purposes. These then turn into a complex network of hundreds of companies within which they can artificially shift the value created by the group to the most favourable jurisdictions. This way companies can, for instance, make a subsidiary pay less tax for the use of their brand in a country where they operate and then bring the profit back into the group's head office.

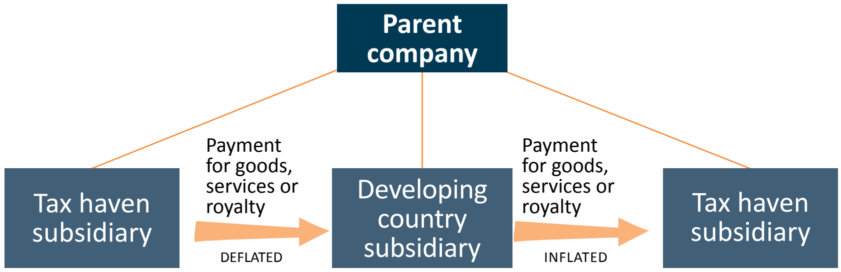
Among other strategies, companies often use tax havens for domiciling their headquarters, creating holding companies, placing intangible assets, and transferring debt and using thin-capitalization methods. Tax havens are "virtual" centres where offshore operations are carried out – and these are known by that name because they take place in legal spaces that separate their actual location from their legal one.

One of the most illustrative examples of the use of these markets is that which came to be known as "the banana case", reported by the British newspaper The Guardian in 2007. In this case, while the actual exported product went directly from Latin American to the United Kingdom, on "paper" it went through seven prior destinations – by crossing the Atlantic Ocean both ways several times – such as the Cayman Islands, Luxembourg, Isle of Man and the Bermuda Islands. Due to all this virtual travel , for instance, bananas were sold out of Guatemala at USD 0.25 per kilo and be sold in international markets at USD 0.80.

b. Tax evasion: illegal practices

The abusive use of transfer prices, which allows transferring capital and assets between different jurisdictions in search of markets with low or zero tax contribution, involves two moves. The first one is fake invoicing, by means of which the sale of certain goods or services is registered at a fake price; the second is trade between subsidiaries of the same multinational company in order to manipulate profit margins depending on the tax advantages provided by each jurisdiction (see Figure 1).

Figure 1. Abusive use of transfer prices



Source: Presentation by Marta Ruiz (Eurodad)

Through the analysis of information on European countries' and the United States' dealings with third countries, Christian Aid has estimated that, between 2005-2007, approximately USD 95 billion were transferred from Latin America as a result of the undervalued trading of commodities. This capital would have generated, if properly declared, USD 31 billion in additional taxes for the countries of that region. The main victims of these practices are the poorest countries. The secrecy and lack of transparency, encouraged by the fact that companies are not under the obligation to declare their profit according to the countries they operate in, make the implementation of controls exremely difficult.

6.2. Proposals for financial reporting on a country-by-country basis

Nowadays it is very difficult to have access to the necessary information to expose these sorts of abuses owing to the high degree of complexity of procedures, and the secrecy within the jurisdictions where companies' subsidiaries are set up. Secrecy combines low degree of company ownership visibility with a high degree of secrecy regarding company information. However, some initiatives are under way which seek to change this reality through greater transparency and oversight:

- The 2002 Extractive Industries Transparency Initiative (EITI), which is focused on eliminating corruption in countries that are highly dependent on the extraction of their natural resources. The major problem is that companies and countries' participation in this initiative is voluntary and the information contained on reports is not standardized, which renders it unsuitable for comparison.
- The 2010 Dodd-Frank Act in the United States (the US Wall Street Reform and Consumer Protection Act), which requires all companies operating in the extractive

sector registered in the US Stock Exchange publish reports on their payments to governments. This includes taxes, which must be broken down on a country-by-country and a project-by-project basis. This Act is coming into force in 2012 and will apply to all companies, not only to those operating in EITI countries. The Act will provide a fairer set of rules that ensure the publication of comparable information.

- The revision of the Mandatory Transparency Standard and the revision of European Standard Accounting Practices. In 2010 a process was set in motion within the European Union, which seeks to update laws for them to be in line with the Dodd-Frank Act. In October 2011, the European Commission submitted a proposal including two important differences in relation to the Dodd-Frank Act: first, it does not apply only to the extractive industries, but also to the forestry sector; second, all companies are included, not only listed ones.

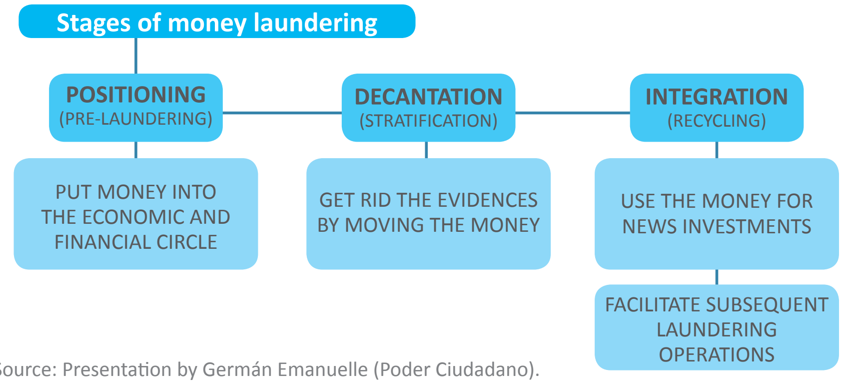
In spite of the progress as a result of these initiatives, large sectors of the economy are not included. Also, the amount of information required is not significant – as it does not go beyond declaring paid taxes– which means it does not provide a solution to the abusive use of transfer prices or other reveal other methods of tax evasion. According to Eurodad, it would be necessary to create a law under which multinational companies (within all sectors) would be required to provide detailed information on their subsidiaries and activities in all countries, in order for tax authorities to finally have the necessary elements to identify potential cases of abusive practices[10].

10. For more information, case studies and analyzes see Eurodad's report: "Exposing the lost billions: How financial transparency by multinationals on a country by country basis can aid development". November 2011. Available at: http://www.eurodad.org/uploadedFiles/Whats_New/Reports/CBC%20report_hi.pdf?n=7530

7. Corruption and money laundering

As Germán Emanuelle (Poder Ciudadano) explains it, money laundering is actually the last link in a long chain of corruption and criminal activities. The process is made up of several stages (see Figure 2), and its completion requires corrupt practices from both government and private sectors, which support this criminal machinery and enables the concealing of the illegal source of money through its incorporation into formal economic activities.

Figure 2. Stages of money laundering



Source: Presentation by Germán Emanuelle (Poder Ciudadano).

This is a rapidly growing phenomenon, especially in Central America and, with particular pace, in Mexico. In this region, the globalisation of the banking system was not accompanied by with a simultaneous updating of the legal systems that enables controlling criminality. Other aspects are usually added to this list of weaknesses, which make a certain country appealing for these illicit practices. For instance, according to Joan Palacios (Jubilee 2000), the use of US dollars as legal tender in Ecuador, as well as the fact that the country has borders with Bolivia, Colombia and Peru – three countries with drug-trafficking activities – facilitates the work of those seeking to incorporate illegal money into the formal economy.

Alberto Di Constanzo, member of the Mexican Parliament, points out that that in Mexico, only 3% of the people prosecuted for money laundering are eventually convicted. It is easier for authorities to pass sentence on the farmers growing the drug rather than on those who finance these activities and then incorporate the multimillion earnings into the legal economic circuit. This is why Mexican drug cartels are the richest ones in the world and, due to this dominant position they are able to maintain confrontations with the state, including confronting the military forces. For Di Constanzo, the answer lies in regional policy coordination – not only regarding information exchange policies, where progress has indeed been made, but also at the judicial level.

However, there is another aspect of the problem that must also be considered. Money laundering is a major part of banks' business. As per Mexican official estimates, annual money laundering operations vary between USD 25 billion and USD 45 billion, which amounts to approximately 70 per cent of the country's monetary base. For this large amount of money to circulate within the market, it must necessarily be also connected to the highest levels of the country's activities, including political campaigns.

Mexico is currently studying the implementation of measures against drug cartels which affect their finances and, in particular, their money laundering activities. After the example set by Spain, policies promoting an active role for citizens as informants of these illicit activities. Di Constanzo says, however, that these measures cannot include revealing the identity of citizens in front of the criminals; authorities must fulfil their role and protect civilians instead of turning them into "spies".

As a result of the ever-growing power of organized crime, Di Constanzo claims the war on organised crime must be made through financial intelligence. The lifting of banking secrecy will have a crucial role to play in this war. If these organizations' financing sources are not attacked in an effective manner, the violence resulting from armed confrontations with drug-dealers – as we see in Mexico – will continue to claim innocent lives.

Generalized corruption, resulting from the huge sums of money managed by those who carry out these illegal practices, also makes the situation worse. Palacios explains that, in the case of Ecuador, entrepreneurs who wish to undertake a project, budget the money to be used for "kickbacks" (bribing) to obtain permits, skip formalities and facilitate proceedings. This popularised vision, which regards corruption as a "natural" part of business, must be changed with measures aiming at transparency in both public and private administrative procedures. In order for this change is to be accomplished, it is essential to strengthen, for instance, oversight systems and access to information on companies' activities, bank account holders, and origin of funds deposited.

If, as Emanuelle explains, corruption is ever more present all along the process ending in money laundering, a war must be waged on many fronts. It is not enough to burn marijuana plantations – the first link in the crime chain – or fighting street drug dealers – the final link. There is an instance that joins both ends together: money laundering, which makes profits "legal" while allowing re-financing of the business. Therefore, one of the main objectives of authorities must be to effectively control these activities, which has an extraordinary strategic value for organised crime.

8. Civil society to government dialogue on fiscal policy and taxation

The debate on tax issues is not a purely technical question and as Jorge Coronado, from the National Alliance Commission and Latindadd, says evidence of that is the fact that a number of countries have come up with tax reforms that are very good from a technical point of view, and yet have not yielded the expected results. There is a political dimension that goes beyond political leaders. Mobilization and social pressure are necessary for increasing general awareness and to place the issue on the civil society agenda.

For Coronado it is clear that, in matters of fiscal and tax policy, governments' agendas do not always coincide with those of wider stakeholders in society. That is why it is important to insist on some points where there is a need for urgent coordinated action from social movements: the fight against tax havens, illicit financial flows, and the capital controls, among other issues. Latin America must observe the experiences of dialogues that have taken place worldwide and, if possible, use such experiences to create a model of their own. As regards to this, Coronado explains, South America has some advantage over Central America, where even in countries with (supposedly) progressive governments, like El Salvador and Nicaragua, the issue of promoting progressive tax systems continues to be a taboo subject.

For María José Romero, from Latindadd and the Task Force on Financial Integrity and Economic Development, the real challenge is to create spaces for dialogue between these two entities – government and civil society – which allows progress towards reforms and proposals agreed by consensus. There is a growing shared view across the world on the need for civil society to participate in decision-making processes. This must be seen as the cornerstone for the creation and strengthening of such spaces.

There are also some experiences of three-way dialogue between government, private sector, and civil society that are worth pointing out:

- With respect to the UN Financing for Development process, as part of the follow-up to the Monterrey Consensus, within the UN framework.
- The OECD informal task force on tax and development – made up of representatives from OECD member and non-member countries, academicics, companies and the civil society.

- The Extractive Industries Transparency Initiative, where the managing board is made up of civil society, private sector and government representatives.

Mauro Andino claims that the basis on which new fiscal models are to be created must be very seriously taken into account. It is not possible to reach significant agreements or enter into new social contracts in countries with a high degree of concentration of incomes, or countries where policies are in place that keep the majority of their citizens in the dark as with respect to decision-making processes that have a direct impact on their lives. This is, says Andino, a culturally-related aspect of the problem that must not be disregarded.

8.1. Case of Peru: SUNAT and the private sector

In surveys carried out in 2008, 65% of Peruvian citizens regarded it a petty offence when companies did not issue invoices for all of their sales made or did not not declare accounting transactions. Moreover, according to Carlos Drago, representative from the National Superintendence of Tax Administration (Spanish acronym: SUNAT), this is the case not just in Peru but also in most Latin American countries. Any system that is set up on the foundation of this flawed approach to taxation, or one that only aims at collecting taxes while disregarding redistributive policies, will necessarily prove as being inefficient as they are unfair.

In Peru, SUNAT has tackled this problem by setting up advisory committees; one of them dealing with domestic taxes and bringing together all unions and representing all economic activities conducted in the country. Through this experience, it was possible for the government to learn about private sector expectations concerning the role of tax administration and convey these expectations from the private sector in view of puting an end to tax evasion.

Drago claims that the major drawback is the lack of organisations' representativeness. In the case of the Chamber of Commerce, for instance, with ten thousand members out of the 1.5 million of registered companies, they can only speak on behalf of a negligible part of society. Moreover, the represented companies are banks, pension funds managing firms, mining and fishing industries and, in general, the wealthiest business and industries in the country. This leaves the major part of society aside, since not even SMEs are included.

Drago also acknowledges there is no "culture" of dialogue from the part of public administration. They are not used to having public policies questioned by civil society organizations through the proposal of topics for face-to-face discussion, let alone having them reveal information and convey their opinion –not even so as to share the difficulties faced at the time of implementing the agreed policies. Hence the importance of all instances for developing and improving that channel for discussion.

9. Conclusions

The original idea that the event organizers had in mind was to lay-out the foundations on which to start constructing in the future. That is to say, this instance was just the beginning of a series. The topics dealt with and examined at this meeting have been left open and are certain to give rise to new concerns and exchanges.

If Latin America is to move forward towards a fairer and more efficient tax system, one that better translates growth into poverty reduction and to greater equality, it is necessary to become aware of the impediments, in social terms, placed by the weakness and regressiveness of tax systems in the region. On top of that there is weakness of public spending structures that do not promote redistribution either. Beyond the technical difficulties, it is indispensable to build political will so as to achieve greater cooperation in fiscal matters which allows fighting the main causes of inequality and poverty in the region. Some of the major problems that need to be addressed are: concentration of income, the lack of fiscal contributions on the part of the economic elite, tax evasion, and the global structures facilitating all of the above.

Some governments and civil society organizations regard UNASUR as a launching pad for effective regional integration. For this to happen, however, two things must occur first: a) UNASUR should persuade Brazil to give up their bilateral trade policies and move on to true multilateralism; and b) Mexico is to step again into its role as leader for Northern part of Latin America and promote its integration and approaching to the rest of the continent.

Latin America cannot fail to use the Mexican presidency of the G20 to its best advantage. It cannot afford to have the three representative countries insisting on individual strategies or strategies based on regional competition that can eventually lead to the detriment of one another. The role to be played in the reconfiguring the new world scene will greatly depend on this.

10. Annex – list of participants

PARTICIPANT	ORGANIZATION	COUNTRY
Abelardo Medina	Superintendence of Tax Administration (SAT)	Guatemala
Adolfo Acevedo	Civil Coordinator	Nicaragua
Adrián Falco	Fundación SES	Argentina
Alberto Adrianzén	Andean Parliament	Peru
Alberto Di Constanzo	Mexican Parliament	Mexico
Aldo Caliari	Center of Concern	United States
Alejandro Gómez	Third World Institute (ITeM)	Uruguay
Alejandro Villamar	Mexican Action Network on Free Trade (RMALC)	Mexico
Alexis Moncada	Christian Aid – Central America	Nicaragua
Ana Lucía Torres	Ministry of Economic Policy Coordination	Ecuador
Bruno Gurtner	Tax Justice Network	Switzerland
Carla Moreno	National Congress	Peru
Carlos Arana Basto	REMURPE	Peru
Carlos Bedoya	*La Primera* Newspaper, Latindadd	Peru
Carlos Drago	National Superintendency of Tax Administration (SUNAT)	Peru
Carlos Benavente	CEDECAM	Nicaragua
Carmela Bardalez	Secretariat General – Andean Community of Nations	Peru
César Flores	National Congress	Peru
Claire Kumar	Christian Aid	United Kingdom
Claudia García	Institute for Strategic Studies and Public Policies (IEEPP)	Nicaragua
Dão Real Pereira Santos	Instituto da Justiça Fiscal (Institute for Fiscal Justice)	Brazil
Eduardo Saravia	CIASE	Colombia
Enrique Daza	Continental Social Alliance – Cedetrabajo	Colombia
Germán Emanuelle	Poder Ciudadano	Argentina
Giancarlo Castiglione	Jubilee Peru	Peru
Giann Velázquez	Forum Solidaridad Peru	Peru
Gilda Solano	Padre Juan Montalvo Center for Social Studies	Dominican Republic
Horacio Rovelli	Ministry of Economy and Public Finance	Argentina
Joan Palacios	Jubilee 2000 – Guayaquil Network	Ecuador
Jorge Coronado	National Alliance Commission	Costa Rica
Jorge Gaggero	CEFID-AR / Tax Justice Network	Argentina
José Cornejo	Andean Parliament	Peru
Juan Pablo Martínez	Federal Administration of Public Revenue (AFIP)	Argentina
Katiuska King	Ministry of Economic Policy Coordination	Ecuador
Lucidio Bicalho	INESC	Brazil
Luis Galicia	AVANCSO	Guatemala

PARTICIPANT	ORGANIZATION	COUNTRY
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Maria Castro	Central American Institute for Fiscal Studies (ICEFI)	Guatemala
María Eulalia Alvarenga	Citizen Debt Audit	Brazil
Maria Estrada	Nicaraguan Institute for Fiscal Studies (INIET)	Nicaragua
María José Romero	LATINDADD – Task Force on Financial Integrity and Economic Development	Peru
Mariana Pimentel	Institute for Fiscal Studies – Getúlio Vargas Foundation	Brazil
Mariela Méndez	Jubilee 2000 – Guayaquil Network	Ecuador
Marta Ruiz	Eurodad	Belgium
Martín Abeles	Economic Commission for Latin America and the Caribbean (ECLAC)	Argentina
Matti Kohonen	Tax Justice Network	France
Mauro Andino	Internal Revenue Service	Ecuador
Mayra Rodríguez	Ecumenical Christian Council	Guatemala
Nicanor Alvarado	Universidad Deusto	Peru
Oriana Suárez	LATINDADD	Peru
Oscar Ugarteche	UNAM, Latindadd	Mexico
Patricia Talavera	Secretariat General – Andean Community of Nations	Peru
Raúl Luna	Consumidores por el Desarrollo (Consumers for Development)	Peru
Ricardo Barrientos	ICEFI	Guatemala
Roberto Bissio	Social Watch – Third World Institute	Uruguay
Rodolfo Linares	International Centre for Human Rights Research (CIIDH)	Guatemala
Rodulio Perdomo	Social Forum on Foreign Debt and Development in Honduras (FOSDEH)	Honduras
Rommel Rodríguez	National Foundation for Development (FUNDE)	El Salvador
Rómulo Torres	LATINDADD	Peru
Rosa Guillén	Group on Gender and Economy	Peru
Roxana Rojas	Financial System Supervisory Authority (ASFI)	Bolivia
Susana Aldana	DECIDAMOS	Paraguay
Tania Quispe	National Superintendence of Tax Administration (SUNAT)	Peru
Verónica Tarzia	Poder Ciudadano	Argentina
Waldo Gómez	Jubilee Foundation	Bolivia