Coordination, Evidence and Accountability:

Reforming the governance of tax expenditures in Latin America

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KEY POINTS

- Governments can use tax expenditures for a range of good reasons. In practice, however, the ways in which tax expenditures are used are often controversial. They represent a significant loss of revenue, can undermine both horizontal and vertical equity, and they are subject to limited scrutiny and debate.
- There is limited research evidence and policy guidance available on how governments do—and should—manage their tax expenditures. Some international organizations have come up with a list of emerging good practice principles. We used these principles as a starting point to look at current arrangements for managing tax expenditures across Latin America.
- No country among those we covered has a comprehensive, organic law that regulates how tax expenditures should be created, managed, and evaluated. Instead, tax expenditure provisions are usually scattered among numerous laws of different types, with clear limitations in the provisions included.
- The role that different actors play in the introduction and implementation of tax expenditures across countries generates dysfunctional systems where nobody holds overall responsibility for the effective management of tax expenditures as fiscal policy instruments, and where governments are not held accountable for the impact of tax expenditures. Narrow sector interests tend to prevail over more general collective considerations, and citizens' and workers' voices are not given sufficient consideration.
- Three areas deserve attention in framing reforms for improving tax expenditure management: (a) improving ***coordination*** by specifying objectives and priorities, concentrating decision making within the finance ministry, and defining clear rules and procedures to be followed; (b) generating and publishing more ***evidence*** on both tax expenditure appraisal and performance at regular intervals; and (c) improving ***accountability*** by improving performance monitoring, introducing mandatory sunset clauses, publishing information on beneficiaries and promoting a broader and more inclusive debate for all tax expenditures.

INTRODUCTION

Since 2016, the LATERAL (Latin America Tax Expenditure Research, Advocacy and Learning) project has brought together a group of ten civil society organizations from across Latin America and the Caribbean to better understand and influence the ways in which governments use—or abuse—tax expenditures as tools for fiscal policy and economic development.[1]

Tax expenditures—also known as tax breaks, tax reliefs or tax subsidies—are special provisions in the tax code that reduce or postpone the taxes owed by specific groups of taxpayers. In theory, governments use them for a range of good reasons, such as benefitting certain individuals (e.g. reducing VAT rates on basic consumption items to benefit poor people), promoting investment (e.g. reducing the burden of taxation for companies that invest in certain sectors or regions), or incentivizing certain behaviors (e.g. reducing taxes paid on the purchase or use of electric vehicles). In practice, however, the ways in which tax expenditures are used is often controversial. For governments, they represent a significant loss of revenue—estimated at between 10 and 20 percent of total government revenues—which can affect their capacity to fund basic services and promote the realization of human rights. They can result in heavily distorted and regressive tax systems, which undermine both horizontal and vertical equity. And while normal budgetary decisions are heavily regulated, decisions about tax expenditures are not, which means that they are subject to limited scrutiny and debate, and are often adopted due to intense lobbying by special interests.

In previous research on the matter, we identified three issues that characterize the management of tax expenditures in Latin America: (a) the lack of adequate transparency and access to information, which prevents proper assessment and deliberation; (b) decision-making processes that are opaque, closed to a limited number of actors, and not linked to the annual budget process; and (c) difficulties in assessing their impact, which often appears limited in any case.[2]

We addressed the issue of transparency in a previous publication[3], where we highlighted how the kinds of disclosure around tax expenditures usually offered by governments in the region do not allow for proper accountability around their use. In this brief, we address the second topic, to look at the ways in which governments decide upon and manage tax expenditures, and the degree to which current arrangements allow for their effective use as fiscal policy instruments.

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[1] See list in Appendix 1.
[2] See https://internationalbudget.org/publications/tax-expenditures-latin-america-civil-society-perspective/.
[3] See https://internationalbudget.org/publications/tax-expenditure-transparency-in-latin-america/.

Each LATERAL partner organization carried out a country assessment based on a common set of questions.[4] The aim was to document what we know about how decisions around tax expenditures are taken in each country, highlighting contradictions and shortcomings. The final objective is to promote an informed public debate on what needs to happen to reform decision-making processes around tax expenditures so that they can become an effective instrument for promoting more inclusive and equitable development.

TAX EXPENDITURE GOVERNANCE: EMERGING GOOD PRACTICE PRINCIPLES

Many of the problems that exist in the ways in which governments manage tax expenditures, and which undermine accountability in their use, are well known to practitioners in the field, but have not been studied in detail, especially in developing countries. As far as we could ascertain, academic research on the topic is very limited. Lack of comparative evidence and in-depth country-specific examples make systematic analysis difficult. As part of the process of writing this brief, we consulted with a number of experts, but did not manage to come up with much in terms of both relevant evidence and specific guidance on how governments do—and should—manage their tax expenditures.

The main exception is a limited number of reports published by international organizations discussing some of the issues and challenges related to a specific type of tax expenditures—fiscal incentives given to businesses to promote investment and spur economic growth. These reports provide some general guidelines that can be useful to get a sense of how governments should think about improving the governance of tax expenditures more in general.

The OECD has put forward a set of principles to “enhance the transparency and governance of tax incentives for investment in developing countries,” which have also been used as a starting point in a joint document that the OECD produced with the IMF, UN and World Bank for the G-20 Development Working Group.[5] These include:

1) Fiscal incentives should be provided through tax laws only, or consolidated into the tax code, and approved by Parliaments
2) The main authority for enacting fiscal incentives should rest with one entity only, ideally the Ministry of Finance, with clear coordination arrangements with other government agencies

[4] The countries covered are Argentina, Brazil, Ecuador, El Salvador, Guatemala, Honduras, Mexico, Peru and Dominican Republic. See Appendix 1 for the list of partner organizations that carried out the country research.

[5] See https://www.oecd.org/tax/tax-global/transparency-and-governance-principles.pdf and https://www.oecd.org/tax/tax-global/options-for-low-income-countries-effective-and-efficient-use-of-tax-incentives-for-investment.pdf. Some of these provisions were also included in the Principles for Human Rights in Fiscal Policies, a collaborative civil society initiative to put human rights and social justice at the center of tax and public spending policies.

3) The performance of fiscal incentives in meeting their stated objectives should be assessed at regular intervals
4) Criteria for granting fiscal incentives should be clearly defined, discretion should be minimized and transparency and accountability should be ensured (e.g., through automatic eligibility criteria, using regular audits and evaluations, publishing names of beneficiaries, etc.)

The same principles have also been taken up and further developed in a recent review of fiscal incentives in Latin America carried out by CEPAL and Oxfam.[6] They also add:

1) Laws establishing fiscal incentives should include a clear statement of their objectives and a policy justification based on cost-benefit analyses
2) All fiscal incentives should have a sunset clause or expiry date, to help ensure an adequate review and evaluation process which can determine their performance and provide an opportunity to decide on their renewal, reform or cancellation
3) Discussions on tax expenditures should be linked to annual budget deliberations, accompanied by disclosures that facilitates comparisons with other budgetary information
4) Decisions on tax expenditures should be based on broad participation by various stakeholders, including civil society

These good practice principles were used as background criteria when LATERAL partners looked at current arrangements for managing tax expenditures across Latin America, to see to what extent they were taken into account.

The remainder of this brief draws on this country-level research, covering the legal and regulatory framework governing tax expenditure policy, the roles and responsibilities of different actors in the formulation and implementation of such policy, and specific examples of different types of tax expenditures across countries. It concludes by drawing together lessons from the country-level research and presenting some recommendations for how governments could improve the governance of tax expenditures in the region.

THE LEGAL AND REGULATORY FRAMEWORK FOR MANAGING TAX EXPENDITURES

Across most of the Latin American countries covered by our project, tax expenditures exist in some sort of a "regulatory void," where limited clarity and weak accountability mechanisms create an environment where

[6] See https://www.cepal.org/es/publicaciones/44787-incentivos-fiscales-empresas-america-latina-caribe.

ineffectiveness, inequity and abuse can thrive. Compared to other budgetary arrangements—such as those linked to regular taxation and spending—the management of tax expenditures is characterized by less transparency, less scrutiny, more fragmented responsibility and lack of coordination. This is partly due to a deficient legal and regulatory framework, where many gaps exist.

While in a number of countries the Constitution does mention tax expenditures, it usually does so in very general terms, and only providing overall guidance on who is responsible for the creation and concession of tax benefits and exemptions of different kinds, and stating the need for a legal basis for all tax expenditures. In some cases, as in Guatemala, the Constitution also defines a number of institutions that are exempt from paying taxes, such as universities and the social security fund, among others.

No country among those we covered has a comprehensive, organic law that regulates how tax expenditures should be created, managed and evaluated. Instead, tax expenditure provisions are usually scattered among numerous laws of different types, from fiscal responsibility laws to laws regulating specific types of taxes, to laws dedicated to promoting economic development more in general (e.g., trade and investment) or that of specific economic sectors (e.g., natural resources, tourism, culture) or specific regions (e.g., free economic zones). Each of these types of laws, however, has clear limitations in terms of the provisions it includes. Fiscal responsibility laws usually only define tax expenditures and include basic transparency and reporting requirements; tax laws tend not to cover policy objectives and policy evaluations; and sector-specific laws are not concerned with the overall coordination of tax expenditure policy across the whole of government. As indicated above, this contributes to creating a weak framework that does not ensure a coherent, comprehensive and effective management of tax expenditures as a fiscal policy instrument. The country whose tax code incorporates some of the more interesting and progressive provisions around the creation of tax expenditures is Peru (see Box 1).

BOX 1. TAX EXPENDITURE PROVISIONS IN PERU'S TAX CODE

Norm VII in Peru's Código Tributario establishes some "general rules for the creation of tax exemptions, incentives and benefits." These state that every proposal for the creation of a tax expenditure will need to:

a) include a Statement of Motives that contains, among other things, the objectives of the proposed tax expenditure, a quantitative analysis of its estimated fiscal cost, and evidence showing its economic benefits and demonstrating that the measure adopted is the most suitable for the achievement of the proposed objectives;

b) be in accordance with the general fiscal policy objectives of the National Government, considered in the Multiannual Macroeconomic Framework or other documents;
c) have a validity that does not exceed three years, renewable for another period of up to three additional years based on an evaluation by the respective sector of the impact of the tax exemption, incentive or benefit. This should look at its influence on the benefited areas, activities or subjects, increased investments and generation of direct employment, as well as the corresponding fiscal cost;
d) include a prior report from the Ministry of Economy and Finance.

Source: Código Tributario, Titulo Preliminar

Furthermore, in a number of countries, tax expenditures can be created in ways that bypass the normal legislative process, further limiting transparency and accountability, and preventing important debates and consultations. The power of the executive to create tax expenditures by decree is often limited—either to small amounts, as in the Dominican Republic, or to the cancellations of certain tax liabilities, as in Mexico and Guatemala—but it can still have a significant impact and important repercussions. In Argentina, tax expenditures created by presidential decrees make up 15-20 percent of the total number of tax expenditures that exist. In Brazil, tax expenditures cannot be created but can be extended—and often expanded—by decree, bypassing an important moment for taking stock and evaluating performance. Still in Brazil, the use of so called "*Medidas Provisórias*" or MPs (temporary measures) has been repeatedly used by the Executive to introduce tax expenditures in a way that limits and shortens the legislative process that proposals need to go through before their approval. This practice has been repeatedly criticized by the country's external audit agency (the *Tribunal de Contas da União*, or TCU), but with limited effect.

Some countries in the region, such as the Dominican Republic, Ecuador and Honduras, have tried at different points in time to introduce new legislation to reform and rationalize their tax expenditures, introducing different restrictions and requirements. In 2013, for example, Honduras passed a law repealing all existing tax expenditures and introducing new rules and procedures, such as an automatic sunset clause of 12 years for all tax expenditures. Even with such reforms, however, tax expenditures in Honduras continue to be among the highest in the region.

KEY ACTORS AND THEIR ROLES IN THE GOVERNANCE OF TAX EXPENDITURES

To understand how decision-making processes around tax expenditures actually work, it is important to go beyond the existence and characteristics of legal and regulatory frameworks for managing tax expenditures in each country, and look at the role that different actors play. In this section, we will look at how the main actors and stakeholders contribute to decisions around tax expenditures, and to their overall management.

Ministries of finance, as highlighted in the emerging good practice principles mentioned above, should have a predominant role in decisions around tax expenditures, and in their overall coordination and management. After all, they are the guardians of the public purse, responsible for formulating the government's overall fiscal policy and overlooking its implementation. This role is sometimes framed in existing legislation across the countries that we looked at, but in practice, however, finance ministries tend to play a much smaller role, failing to provide effective overall coordination and management. In some cases, their role is limited to vetting and providing technical opinions on tax expenditure proposals, producing and publishing estimates of the cost of tax expenditures, and sitting on committees responsible for their management alongside a number of other actors and not as *primus inter pares*, without any overall authority nor a clear role in both planning and evaluating tax expenditure policy as a whole on behalf of the government. The reasons for this are not clear, but may result from a number of factors, including lack of adequate capacity, of a clear legal backing for a strong coordinating role, weak coordination arrangements with other government agencies and the stronger role played in some cases by other actors like sector ministries or the legislature, which often undermine the finance ministry's capacity to hold the reins of overall tax expenditure policy.

Revenue administrations are autonomous agencies that are separate from the finance ministry in most—if not all—of the countries that we looked at as part of this project. In all countries they play an important role in managing the implementation of tax expenditures and in producing, collecting and publishing relevant data and information. They have a more limited role in the formulation of tax expenditure proposals, mostly focused on providing technical inputs and assessments. Their focus on tax administration and implementation means that their role does not include overall policy coordination or evaluations of the impacts of tax expenditures beyond their immediate cost in terms of reductions in revenue.

Other government ministries—including ministries responsible for economic development, trade and specific sectors like tourism or mining and energy—often play an important and somewhat disproportionate role in tax expenditure policies, especially those aimed at promoting investment and economic growth more in general. These ministries see fiscal incentives as important tools to promote growth and attract investment in their respective sectors, and therefore promote their adoption acting in collaboration with private sector actors (more on this below). Unfortunately, these actors do not have an incentive to take into consideration the negative impact on revenue collection that fiscal incentives have, and the repercussions that this may have on service provision in other sectors. This can create important contradictions for overall fiscal policy. In cases where fiscal incentives are provided through legislation to promote the development of specific sectors, some of the provisions can be in clear conflict with other laws promoting fiscal responsibility, for example, or requiring minimum levels of spending in social sectors. In other words, while sector policies may make sense individually, as a whole they risk undermining the government's commitment to a responsible management of public finances. In some cases, sector legislation also includes the creation of *ad hoc* councils or other bodies which include sector ministries and private sector actors and gives them important responsibilities for managing tax expenditures, such as certifying potential beneficiaries. Examples include the Council for Free Exporting Zones (*Consejo Nacional de Zonas Francas de Exportación*) and the Council for Tourism Promotion (*Consejo de Fomento Turístico* or Confotur) in the Dominican Republic. In some cases, the finance ministry is not even a member of these councils. Apart from creating clear conflicts of interest and a fuzzy separation between government and private sector actors and interests, these arrangements further undermine the government's capacity to effectively manage tax expenditures.

Legislatures seem to play a lopsided role when it comes to tax expenditures in the countries we looked at. As most tax expenditures are introduced via the legislative process, legislatures are involved in reviewing the proposals and approving them. Unfortunately, these discussions usually happen separately from the regular budget process and with limited consultations with relevant stakeholders, preventing a more inclusive and comprehensive discussion of fiscal policy. In some cases, legislators can also introduce tax expenditure proposals directly, rather than wait for the executive. In doing this, they are often lobbied by private sector interests. Legislatures, on the other hand, seem to have a very limited role in monitoring and evaluating implementation of tax expenditures, even when they are called on to approve renewals and extensions of existing ones.

External auditors have not played a very significant role in most of the countries we looked at, despite the clear interest that they should have in such an important and opaque area of public finance. There are a few exceptions to this that point to ways in which supreme audit institutions (SAIs) could get more involved in ensuring better overall governance of tax expenditures, and their more effective use as fiscal policy instruments. In Brazil, the *Tribunal de Contas da União* (TCU) has repeatedly called for limiting the use of *Medidas Provisórias* as an avenue for introducing tax expenditures, and for respecting the requirement in fiscal responsibility legislation to include compensatory measures whenever revenues are lost due to the introduction of a tax expenditure. Unfortunately, both of these recommendations seem to have been repeatedly ignored by the executive. In Mexico, the *Auditoría Superior de la Federación* (ASF) carried out a performance audit of tax expenditure policies over the period 2013-2018 that included some very interesting findings and recommendations (see Box 2).

BOX 2. MEXICAN AUDITORS LOOK AT TAX EXPENDITURE GOVERNANCE

In 2019, the ASF published a report titled "Revenue Policy Formulation: Tax Expenditure Budget", which looked at the process for formulating and monitoring the implementation of the tax expenditure budget in Mexico by the finance ministry (*Secretaría de Hacienda y Crédito Público*, SHCP) and the revenue administration (*Servicio de Administración Tributaria*, SAT).

The report highlighted a number of issues and shortcomings in the government's management of tax expenditures. These include:

- The SHCP has not clearly defined who is responsible for preparing the tax expenditure budget. As a consequence, there is also no precise mechanism for monitoring their implementation, evaluate their results, and assess their impact on government revenues.
- There is no clear coordination between the SHCP and the SAT for monitoring and evaluating the implementation of tax expenditures, nor to make the process transparent.
- There is no system in place to measure social and economic impact of tax expenditures, including on aspects such as inequality and the distribution of income, the wellbeing of citizens, the promotion of investment and the generation of jobs in benefited sectors.

The ASF issued a series of recommendations for the SHCP and the SAT to implement which could significantly shift and improve the governance of tax expenditures, especially in terms of ensuring that their broader impacts are monitored and evaluated.

Source: Audit Report 2018-0-06100-07-1725-2019

Among non-state actors, **private sector** bodies like corporations and business associations play a significant role in lobbying for fiscal incentives for their respective sectors and activities, trying to influence decisions both by the executive and the legislature. They are often the privileged counterpart when consultations happen, organized by either the executive or the legislature. In some cases, as already mentioned, they are also members of *ad hoc* councils where they are involved in taking decisions on the implementation of tax expenditures, which represents a clear conflict of interest.

Civil society organizations, including trade unions, on the other hand, do not play a prominent role in decisions around tax expenditures. Spaces for debate and participation are quite limited—and often predominantly occupied by private sector lobbies—and the lack of access to adequate information often prevents independent analysis of tax expenditure policies and their impacts. CSOs across the region are increasingly getting mobilized to advocate for more transparency and accountability in the use of tax expenditures, and for the end of the most striking "fiscal privileges" that tax expenditures generate, but they have so far had limited impact.

The above description (summarized in Table 1 below) of the role that different actors play in the introduction and implementation of tax expenditures reveals a dysfunctional system across many countries where nobody holds overall responsibility for the effective management of tax expenditures as fiscal policy instruments, and where governments are not held accountable for the impact that tax expenditures have not only on government revenues, but also on the economic sectors that they are intended to benefit and on society as a whole. This was effectively described by our partner in El Salvador:

> "*Institutional deconcentration in the granting of tax incentives, with limited or weak participation by the State finance body both in granting and coordinating them, increases the discretionary power of other authorities in granting them, decreasing consequently, the capacity to control, monitor and evaluate compliance with the commitments assumed by the beneficiaries to receive the benefits.*"[7]

In other words, narrow sector interests tend to prevail over more general collective considerations, undermining the government's capacity to manage tax expenditures as part of overall fiscal policy. Furthermore, citizens' and workers' voices are not given sufficient consideration, as debate tends to be very limited. In the next section, we will show how this has played out across countries using concrete examples.

TABLE 1. EXPECTED AND ACTUAL ROLES OF DIFFERENT ACTORS IN THE GOVERNANCE OF TAX EXPENDITURES

Actor	Expected role	Actual role
Ministries of Finance	Overall responsibility for policy, coordination, and management (including evaluation)	• Vetting and providing technical opinions • Publishing cost estimates • Sitting on management committees as regular members
Revenue Administrations	Overall responsibility for implementation	• Day-to-day management • Producing data and information
Other ministries	Presenting tax expenditure proposals to responsible authorities	• Disproportionate role in policymaking and implementation

[7] El Salvador country case study, page 10.

		• Chairs of *ad hoc* councils and management committees
Legislatures	Reviewing, debating, and approving tax expenditure proposals as part of budget deliberations	• Limited scrutiny and consultations • Introducing tax expenditure proposals independent of executive
External auditors	Auditing tax expenditures as regular spending programs	• Very limited (if any) role in auditing tax expenditures
Private sector	Participating in policy debates	• Lobbying both the executive and the legislature for specific tax expenditure policies • Privileged counterpart in consultations • Members of ad hoc councils and management committees
Civil society	Participating in policy debates	• No significant role in debates and decisions around tax expenditures

Source*: Author*

TAX EXPENDITURE GOVERNANCE IN THE REAL WORLD: SOME EXAMPLES

As part of the research process, LATERAL partner organizations looked into the process for introducing specific tax expenditures in each country, to get a sense of how decisions were taken, the role that different actors played, and the extent to which this allowed for effective management and accountable governance of tax expenditures. This section looks at some of these examples. Most cases looked at the process for granting fiscal incentives to different sectors considered key for the economic development of each country. The analysis reveals some important elements that characterize decision making processes around tax expenditures across the region, above and beyond those already described in previous sections.

In **El Salvador** and **Guatemala**, the case studies looked at the introduction of new legislation to support export processing and free economic zones (*zonas francas*) in both countries, considered to be very important to attract investment, promote exports and generate jobs. In both countries, the relevant laws have a long and often tortuous history, marked by various attempts by specific private interests to obtain tax benefits for their sectors and activities, rather than guided by a clear and coherent policy by the government to promote investment and growth. All of this in face of ample evidence that promoting investment through *zonas francas* has at best limited impact on growth and employment, and often creates imbalances that negatively affect other sectors of the economy.[8]

[8] For an example, see https://icefi.org/sites/default/files/icefi_ints_la_eficacia.pdf.

In El Salvador, the current legislation was introduced in 1998 promoted by the Presidency and the Ministry of Economy, and underwent since then a number of reforms and adjustments, many of them expanding the range of sectors and activities that could benefit from fiscal incentives. None of these reforms was based on evaluations that guided policy design, nor included clear performance criteria to be monitored, as they were mostly formulated in response to lobbies by various private sector actors.

In Guatemala the process was somewhat different and to some extent more inclusive, but again highlights a similar pattern of private sector influence and lack of clear government policy. New legislation reforming fiscal incentives for free economic zones took almost four years to be passed—from 2013 to 2016—and was characterized by numerous failed initiatives by Congress, lobbied by the private sector, to expand fiscal incentives. A number of proposals were opposed by both key actors within government, including the ministry of finance and the revenue administration, who were worried about revenue loss and implementation challenges, and other actors like business associations representing sectors that could be negatively affected by the inequities that the incentives introduced, and civil society organizations. After repeated failed attempts, eventually a consensus proposal was reached following more inclusive consultations, introducing clearer rules and limiting benefits to relevant sectors, which was eventually approved as the Emerging Law for the Conservation of Employment (*Ley Emergente para la Conservación del Empleo*) of 2016. Unfortunately, since then there have been various attempts by excluded sectors to lobby both Government and the Congress, pushing for their inclusion.

The cases of **Argentina** and **Brazil** discuss tax regimes for another sector that is often considered key in attracting investment and promoting growth, that of the extraction of natural resources. As in many cases, both countries provide ample tax incentives to companies investing in the extractive sector, again despite limited evidence of the impact that such incentives bring, which in turn prevents any real accountability.

In Argentina, the law that frames incentives for the mining sector dates back to 1993, and it provided a series of long-term tax reductions (30 years) to companies investing in mining activities. While the law set out the main objectives that it meant to pursue, which included attracting investment, improving the trade balance and creating jobs in underdeveloped areas, no clear parameters for evaluating the achievement of such objectives were put in place. Many doubts were expressed by legislators during the parliamentary debate, including on tying the hands of the government for such a long period of time and on the importance of monitoring and addressing the environmental impacts of mining investments. But the urgency of putting in place what was considered to be a favorable investment regime for a strategic sector led to a rapid approval of the law. Thirty years on, the lack of clear objectives and monitoring information at the beginning of the process has led to implementation arrangements that are weak on review and evaluation mechanisms. In 2020, the Mining Department (*Secretaría de Minería*) of the Ministry of Productive Development (*Ministerio de Desarrollo Productivo*) approved a strategic plan that included as an objective "ensuring the correspondence between the fiscal cost of policies for the promotion of mining activities and the real development of investment." Unfortunately, monitoring and control activities planned in support of such objective lack clear baselines, as evaluations have not been properly planned until now.

In Brazil, the "Special customs regime for exporting and importing goods for research and mining activities in oil and natural gas deposits" (*Regime Aduaneiro Especial de Exportação e de Importação de Bens Destinados às Atividades de Pesquisa e de Lavra das Jazidas de Petróleo e de Gás Natural*), more simply known as Repetro, was created in 1999, but underwent a major revision in 2017 which extended its duration until 2040 and expanded its reach to include a special taxation regime on top of the existing customs one. The passing of the 2017 reforms was fast-tracked as the government was pushing for the internationalization of the oil and gas sector in the country, and multinational corporations were lobbying the government to open up the sector to foreign investment. Despite clear opposition from many parties in Congress and a number of civil society organizations, based on some evidence on its expected negative impacts, the "*MP do trilhão*" (or "one trillion MP," named after its estimated cost to the public coffers) was speedily approved and is now being fully implemented. In the words of our Brazilian researcher,

> "*Repetro is an example of the various weaknesses of the Brazilian tax expenditure approval and management system. First, because it was not created by specific law, but by* Medida Provisória*, thus directly violating the Constitution. Second, for not having any compensation measures introduced, as required by the Fiscal Responsibility Law. Third, for having its process cut short in the parliamentary committees, which made popular participation impossible and facilitated the non-commitment of the legislature to such compensation measures. Finally, as it is not included in the Tax Expenditure Statement (*Declaração de Gastos Tributarios*, DGT), preventing the regime from being monitored by the revenue administration or by civil society. In this sense, we have an opaque regime, which costs tens of billions of Reais a year, reducing the financing of public policies in Brazil and increasingly favoring foreign companies and the production of fossil fuels in Brazil.*"[9]

In the **Dominican Republic** and **Mexico**, the case studies relate the stories of reforms aimed at promoting other sectors which are important for these two countries' economic development, namely tourism in the DR and the primary sector (farming, forestry and fishing) in Mexico. Again, the cases show how governments are willing to accept the demands of private sector actors for tax benefits without sufficient evidence nor adequate countervailing demands.

[9] Brazil case study, paper available upon request.

The Dominican Republic has five different laws that include fiscal incentives for the tourism sector that were passed over the past 20 years or so, the last one being introduced in 2013, with a tendency to extend and increase tax benefits for investors and tourism operators over time. The process that led to these reforms saw a strong presence of private sector organizations and business associations representing tourism operators, putting pressure on the government and on the legislature to extend existing fiscal incentives. Private sector influence is also very clear in the operations of the Confotur, which includes private sector actors and is in charge of certifying the beneficiaries. The finance ministry, on the other hand, played a very limited role in the consultations before the introduction of the law, and despite having carried out some evaluations of its fiscal impacts, it has not made them public. Independent evidence, however, points to the fact that existing fiscal incentives for the tourism sector are not cost-efficient and should be reformed. The generous incentives regime is also in clear contradiction with the government's commitment to promote a "fiscal pact" (*Pacto Fiscal*) aimed at increasing the efficiency, transparency and equity of the tax system and consolidating all fiscal incentive regimes into the Tax Code, among other measures.

In Mexico, the government proposed the elimination of a simplified tax regime for a number of sectors including the primary sector in 2013-14, arguing that it would make the tax system more equitable and help avoid abuse of the simplified regime by large companies that were not supposed to qualify. While explaining the initiative to legislators, the vice-minister for review at the time argued that too many loopholes and special treatments may in fact hamper economic growth, based on Mexico's lackluster growth figures and its large number of tax incentives. The government proposal met with strong opposition by private sector actors and ended up being withdrawn and substituted by a different tax regime that maintained most of the benefits—and problems—of the previous one. Tax expenditures for the primary sector have increased since then, and the benefits continue to be concentrated among rich taxpayers.

As can be seen in the examples above, which depict how decisions around the introduction and implementation of tax expenditures were taken in some specific cases in the countries covered by our project, tax expenditure governance in Latin America suffers from a series of important problems. These include the weakness of governments' policy frameworks around both planning and evaluation of tax expenditures, the lack of adequate evidence and analysis both to guide decisions on and to review the performance of tax expenditures, and the oversized influence of private sector actors and interests in shaping government policy around tax expenditures, to the detriment of other important voices.

In the next section, we discuss some recommendations for how governments should address these problems, introducing reforms that could drastically improve tax expenditure governance.

REFORMING TAX EXPENDITURE GOVERNANCE: WHAT CAN GOVERNMENTS DO?

It is clear from the evidence we gathered that governments across Latin America have a long way to go to ensure that tax expenditures are managed in a way that is more effective and accountable. Building on the evidence summarized above, and on the good practice principles already put forward by international organizations, three areas deserve particular attention when thinking about the reforms that governments can adopt to improve the situation.

COORDINATION

Our case studies show that responsibility for managing tax expenditures is often fragmented, leading to inefficiencies and contradictions. To improve this, governments can:

a) Adopt policy frameworks for tax expenditures that clearly specify policy priorities and reconcile contradicting objectives (e.g., fiscal responsibility or financing of social policies vs. promoting investment)
b) Concentrate overall responsibility and decision-making powers for the management of tax expenditures within the Ministry of Finance, and strengthen central planning and evaluation functions
c) Define basic rules to be followed for the decision-making process around tax expenditures, specifying the role of different actors and integrating it to the extent possible with normal budgetary procedures

EVIDENCE

As our case studies show, decisions around tax expenditures are too often taken based on limited evidence. Governments can:

a) Generate and publish more evidence on both tax expenditure appraisal and performance at regular intervals. This should include information on their fiscal cost, on their impact on their specific policy objectives, and on their impact on broader socioeconomic variables—including income distribution—and on human rights
b) Devolve some of the responsibility for providing key data and information on tax expenditure performance to the beneficiaries of specific tax expenditures

ACCOUNTABILITY

Decision making processes around tax expenditures across our case studies are characterized for a lack of clear accountability mechanisms, meaning that ineffective and inequitable tax expenditures are adopted—and often regularly extended—without adequate review and evaluation. Governments can:

a) Define clear policy objectives for all tax expenditures, accompanied by performance criteria and monitoring and evaluation arrangements
b) Introduce mandatory sunset clauses for all tax expenditures, to ensure that review and evaluation can happen at regular intervals
c) Provide information on the companies benefiting from tax expenditures measures
d) Ensure a broader and more inclusive debate and the participation of a variety of actors in decisions around tax expenditures, including civil society organizations, academia/think tanks and representatives of affected stakeholders

Policy makers, legislators, civil society representatives and other relevant actors should start a discussion on the above ideas for reforming tax expenditure governance, in Latin America and beyond. Tax expenditures are too important an area of public finance and fiscal policy to be left unregulated, untransparent and unaccountable. Of course, some of the above reforms are not easy to implement, require strong political commitment and rely on long-term institutional reorientation and capacity development. Some of the difficulties also stem from the lack of a clear regulatory framework for decision making around tax expenditures. One interesting possibility would therefore be to start an inclusive debate on the introduction of new legislation defining an overall framework for tax expenditure governance and regulating the adoption, implementation and monitoring of tax expenditures. Such a framework could include key principles, rules about the decision-making process, the roles and responsibilities of different actors, transparency and accountability requirements, monitoring and evaluation arrangements, etc.

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APPENDIX 1: LIST OF PARTICIPATING ORGANIZATIONS

Argentina: ACIJ - Asociación Civil por la Igualdad y la Justicia

Brazil: INESC - Instituto de Estudos Socioeconômicos

Dominican Republic: Fundación Solidaridad

Ecuador: Grupo Faro - Fundación para el Avance, las Reformas, y las Oportunidades

El Salvador: ISD - Iniciativa Social para la Democracia

Guatemala: ICEFI - Instituto Centroamericano de Estudios Fiscales

Honduras: FOSDEH - Foro Social de la Deuda externa y Desarrollo de Honduras

Mexico: FUNDAR - Centro de Análisis e Investigación

Peru: CAD - Ciudadanos al Día

APPENDIX 2: KEY QUESTIONS FOR COUNTRY-LEVEL RESEARCH

1) Legal and regulatory framework

a) Is there a specific comprehensive/organic law regulating tax expenditures? If so, what are its main provisions?

b) Are all tax expenditures based on laws approved by Parliament? If so, what kinds of laws are used to approve tax expenditures (tax laws, investment laws, sector development laws, etc.)? What kinds of provisions do these laws usually include?

c) If not, what other regulatory instruments are used to approve tax expenditures? What kinds of provisions do these instruments usually include?

d) How closely does the existing legal and regulatory framework around tax expenditures comply with the emerging principles of good practice outlined above?

2) Key public actors and their functions

a) Who are the key actors involved in deciding on tax expenditures?

b) Who are the key actors involved in managing tax expenditures?

(for both questions, comment on the roles of—at least—the finance ministry, the revenue administration agency, sector ministries, the legislature, the supreme audit institution, etc.)

c) What are their powers in tax expenditure management? And what are their incentives?

d) What degree of discretion do different actors have in managing tax expenditures?

3) How things work in practice at different stages of the process

a) Based on 1-2 examples of specific tax expenditures, researchers should look at how decision-making has worked in practice: (i) during the design and approval of specific tax expenditures; (ii) during the management of their implementation; and (iii) during the evaluation and reviewing of their performance (if done).

b) In these examples, who were the main private actors involved in the decision-making process? How did they participate in the process? How did they influence it?

LATERAL PROJECT

This publication was developed as part of the Latin America Tax Expenditure Research, Advocacy, and Learning (LATERAL) project. LATERAL is an innovative collaborative research, capacity-building, and advocacy initiative that was launched by the International Budget Partnership (IBP) and ten Latin American civil society organizations (CSOs) in 2016 to support CSO work on increasing the transparency, accountability, and equity of tax expenditure policies at the country and regional levels.

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