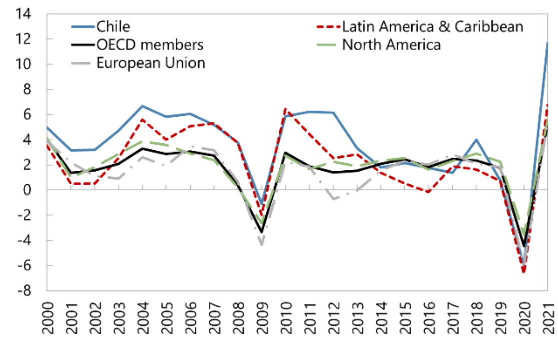
TAX REFORM SCENARIOS IN INTERNATIONAL PERSPECTIVE[1]

A. Introduction

1. Over the last decades, Chile has achieved strong economic growth, while making progress on poverty reduction. Strong growth has been underpinned by macroeconomic stability, very robust macroeconomic policies, and very strong institutional policy frameworks. The average GDP growth rate over the last two decades in Chile (3.7 percent) has been significantly above the Latin American and Caribbean (LAC) (2.3 percent) and the OECD (1.8 percent) averages.

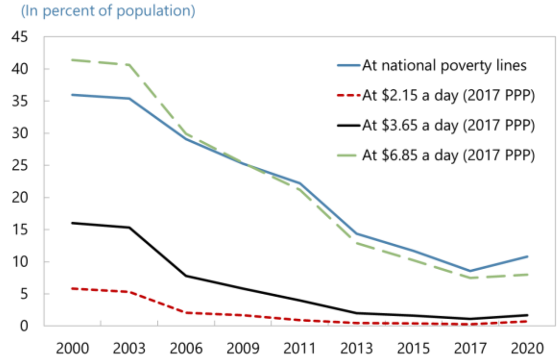
GDP Growth Rate, 2000-2021
(In percent, yoy)



Sources: WEO and IMF staff calculations.

2. Strong growth translated into a rapid reduction in poverty rates and better living conditions for large segments of the population. The poverty headcount dropped from around 35 percent in 2000 to slightly above 10 percent in 2019. Extreme poverty appears to have been virtually eliminated. Hadzi-Vaskov and Ricci (2021) further show that since at least 2005, the share of vulnerable population declined significantly in Chile, while it remained roughly constant in LAC as a whole. Similarly, they show that Chile had the largest share of vulnerable population among LAC economies in 2005-2008 but reached one of the lowest shares in 2015–2018. These trends coincide with a steady increase in social spending, both as a share of total government expenditure and as a share of GDP.

Evolution of the Poverty Headcount, 2000-2020
(In percent of population)

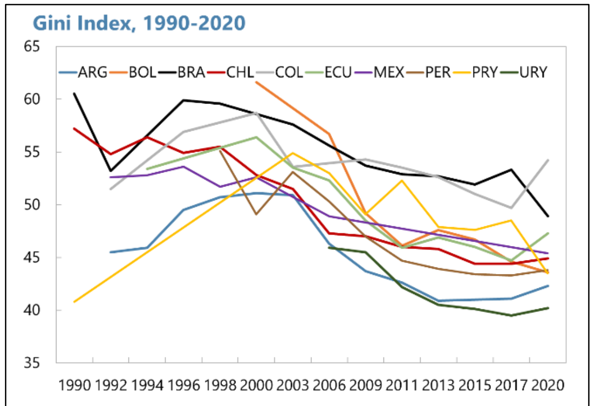


Sources: World Bank, World Development Indicators, and IMF staff calculations.

3. While the economic and social outcomes achieved by Chile have been impressive, important social challenges lie ahead. In 2019, the country experienced unprecedented social unrest that had a long-lasting social and economic impact and ignited a process to reform the constitution (see Box 1 of Chile: Staff Report for the 2022 Article IV Consultation). Social demands were wide ranging, but a common thread was the perception of increased inequality, lack of access

[1] Prepared By Eduardo Camero (FAD)

to the economic benefits of macroeconomic stability, and rising cost of living. Hadzi-Vaskov and Ricci (2021) suggest the following main reasons may explain the unrest in Chile:



Sources: World Bank, World Development Indicators, and IMF staff calculations.

- **Income inequality.** Although income inequality declined steadily since 1990, it remains one of the highest in the world, even when comparing with countries at similar development level.

- **Perceived inequality.** Chile has the largest gap between perceived and actual inequality in the group of Latin American countries. Interestingly, in Chile perceived inequality increased while inequality measured by the Gini coefficient declined.

- **Inequality of opportunity**. Consistent with persistently high income inequality, Chile has relatively low earnings and social mobility.

- **Inequality of access to essential services**:

  - *High out-of-pocket health expenses*. Households' out-of-pocket health payments in Chile have been at the top within OECD countries and at the very top among countries at similar level of development.

  - *Inadequate pensions*. Replacement rates in Chile are low within the OECD, even more so for women. There are many reasons that contribute to such an outcome, including low contribution rates, poor contribution density, under-reporting, and low retirement ages.

  - *Decreasing returns to education*. Despite spending per student being in line with international benchmarks, the quality of education in Chile is relatively low compared to the OECD (but high compared to regional peers). Furthermore, returns to schooling and the education premium have decreased in Chile, which might have led to unmet expectations of young graduates, creating frustration and social discontent.

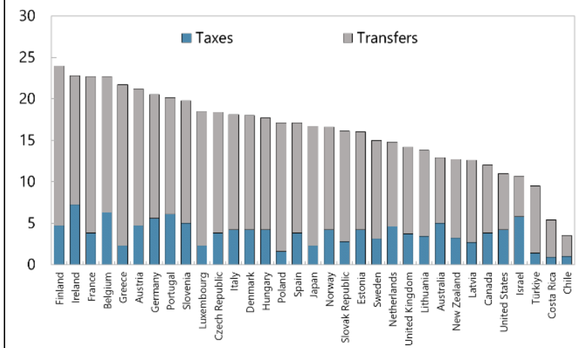
4. **Addressing social challenges will require a new landscape for public finances that must be balanced with fiscal sustainability**. The authorities remain committed to reducing the structural fiscal deficit to broadly balance over the medium term (from a deficit target of 2.1 percent in the 2023 Budget) and stabilizing gross public debt below 45 percent of GDP, which they consider a prudent debt level.

5. **The government has embarked on an ambitious tax and expenditure reform agenda.** A comprehensive tax reform under discussion in Congress aims to gradually raise net revenues by about 3.5 percent of GDP by 2026. Plans to address social needs are also expected to be

comprehensive, covering education, health and housing, dependent care, and pensions. A pension reform proposal was submitted to Congress in November, while other reforms are expected to be submitted in the period ahead.

6. **An adequate tax and spending strategy can foster both inclusion and growth.** It can also mitigate risks of social unrest that can have non-linear and lasting effects on economic growth. In other OECD countries, the fiscal system can significantly reduce income inequality; countries like Finland, Ireland or France achieve a reduction of the Gini coefficient of more than 20 points, mostly via the effect of transfers. The redistributive effect of the fiscal system in Chile remains the lowest in the OECD, accounting for less than 5 points of the Gini coefficient (3 points from transfers and 2 points from taxes).

Redistributive Impact of Taxes and Public Transfers
(Reduction in the Gini Coefficient in percent)



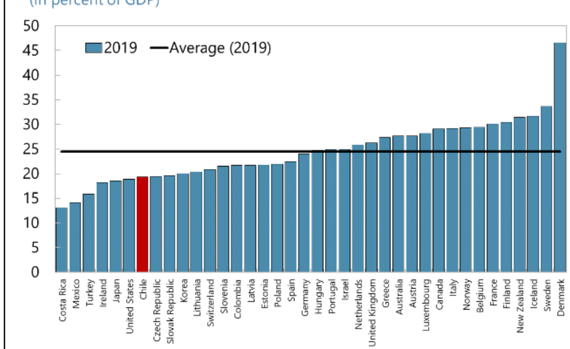
Sources: OECD Income Distribution Database and IMF staff calculations.

7. **Against this background, this paper benchmarks the estimated revenue gains of the tax reform proposal and discusses different fiscal consolidation scenarios**. The paper is organized as follows. Section B presents the stylized facts of the tax system in Chile compared with OECD countries. Following a very brief overview of the tax reform proposal, section D presents a benchmark analysis of the estimated revenue yields against similar domestic revenue mobilization episodes in OECD countries. Section E brings the analysis together under scenarios for fiscal consolidation and fiscal space for increasing social spending in Chile. The last section concludes.

B. Stylized Facts of the Tax System in Chile

8. **Chile's tax revenue collection is relatively low compared to OECD countries**. Over the last decade, total tax revenue[2] in Chile hovered between 18 and 20 percent of GDP. In 2019, before the pandemic, tax revenue reached 19.4 percent of GDP, only above Costa Rica, Mexico, Turkey, Ireland, Japan, and the United States. To reach the (simple) OECD average, tax revenues would need to increase by around 5 percent of GDP (and would reach a level similar to Germany, Portugal, or the Netherlands). To get to

Total Tax Revenue, 2019
(In percent of GDP)



Sources: WORLD database and IMF staff calculations.

[2] Total tax revenue is taken from the IMF World Revenue Longitudinal Database (which prioritizes data from the OECD Global Revenue Statistics Database for OECD countries) and includes all major taxes, such as on personal and corporate income, goods and services (including value added), property, payroll, trade, and other or unidentified. It does not include social security contributions.

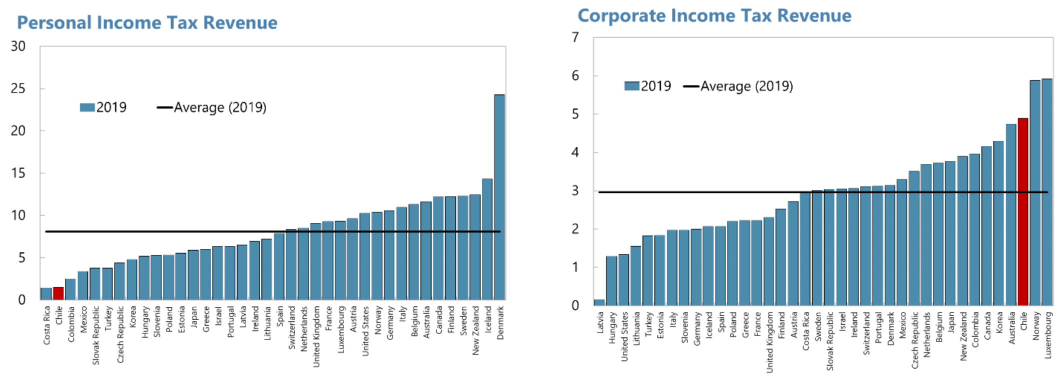
the average of the second quartile of OECD countries, tax revenues would have to increase by 2.4 percent of GDP.

9. The very weak performance of personal income tax (PIT) collections contrasts with above average revenues from the corporate income tax (CIT). The PIT collects only 1.5 percent of GDP (a tad above Costa Rica), 6.6 percentage points of GDP below the OECD average. The low performance of PIT is likely due to the very high exempt tax threshold—equivalent to 80 percent of Chile's per capita GDP—and leading to only about 25 percent of registered taxpayers with income above the threshold. In addition, PIT tax rates for low and middle brackets are modest, and only increase significantly for the highest brackets. On the other hand, the performance of CIT in Chile is amongst the strongest in the OECD (4.9 percent of GDP, about 1.9 percentage points higher than the OECD average).

10. VAT collections are also above the OECD average, while excise and property taxes are below average. Revenue from VAT (8.3 percent of GDP) is higher than the OECD average (6.9 percent of GDP). On the other hand, property taxes in Chile generate 1.1 percent of GDP, almost 0.7 percent of GDP less than the average for the OECD (1.8 percent of GDP). From excise taxes (not shown), Chile collects 1.5 percent of GDP, almost one percent of GDP less than the average for the OECD (2.4 percent of GDP), which might reflect, among other things, relatively low taxation of diesel in Chile.

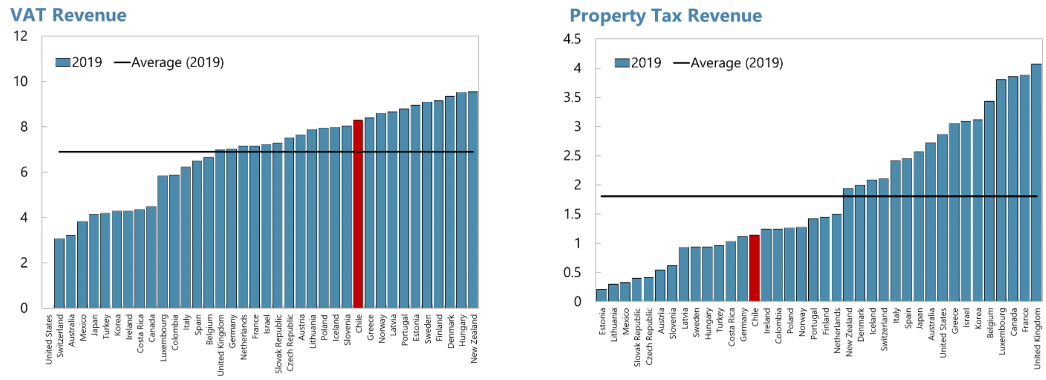
Income Tax Revenue in OECD Countries, 2019

(In percent of GDP)



Sources: WORLD database and IMF staff calculations.

VAT and Property Tax Revenue in OECD Countries, 2019
(In percent of GDP)



Sources: WORLD database and IMF staff calculations.

C. Main Elements of the Authorities' Tax Reform Plan

11. The tax reform plan unveiled in June 2022, and currently under discussion in Congress, is ambitious and comprehensive. It pursues worthwhile goals, including raising revenues for an expansion of social services; increasing the progressivity of the tax system; simplifying and lowering compliance costs; reducing incentives for aggressive tax planning; and fostering a green economy.

12. The most important elements include:[3]

Estimated Revenue Yields from Proposed Tax Changes
(In percent of GDP)

	2023	2024	2025	2026
Income taxes	0.2	0.6	0.7	0.8
Wealth	0.0	0.3	0.4	0.4
Reduction of exemptions'	0.0	0.0	0.0	0.2
Tax administration	0.4	0.8	1.2	1.6
Royalty	0.0	0.1	0.5	0.5
Corrective taxes	0.0	0.0	0.1	0.3
Total increase in revenues	0.6	1.8	3.0	3.8
Tax expenditures	0.0	-0.4	-0.3	-0.3
Net increase in revenues	0.6	1.4	2.7	3.5
Differences with original proposal	0.0	-0.5	-0.5	-0.6

Sources: Ministry of Finance and IMF staff estimates.

- A move from semi-integrated income taxation to a dual system, with a new tax on capital income.
- A broadening of the tax net to retained profits, via a tax on retained earnings for firms with a majority of revenues from passive sources.
- A more progressive PIT (but with additional deductions for rental and dependent-care expenses).
- A new wealth tax.
- A lower CIT rate from 27 to 25 percent (but only if a comparable amount is spent on productivity-boosting investments).

[3] See also Annex IX in Chile Staff Report for the 2022 Article IV Consultation.

- Tax administration measures to reduce tax evasion and elusion (including a new anti-avoidance rule, a fiscal whistleblower program, more relaxed banking-secret restrictions vis-à-vis the tax authority, and more stringent transfer pricing regulations, among others).

- Modifications to mining taxes, e.g., the introduction of a moderate ad-valorem royalty and higher rates of the current special mining tax.

D. Benchmarking the Tax Reform Proposal in International Perspective

13. This section benchmarks Chile's tax reform plan, focused on the direct tax components, against similar episodes of domestic revenue mobilization in the OECD. Following the methodology in Akitoby and others (2018), a simple comparative exercise is undertaken for OECD countries that underwent revenue mobilization episodes that were similar in terms of revenue yields and duration to that of Chile's plan. This methodology consists of:

- Data on tax revenues as a percent of GDP are assembled for 2000–2019 for all OECD countries from the WORLD database.[4]

- For different combinations of tax handles, an "episode" is identified as a (continuous) four-year window for a given country during which the yearly tax-to-GDP ratio grew on average by the same amount as in the tax reform under discussion in Chile (for the same combination of taxes).[5]

- For each episode identified, three attributes are calculated:

    - Duration, defined as the number of consecutive years in which the tax-to-GDP ratio is increasing.

    - Yield, defined as the accumulated increase in the tax-to-GDP ratio.

    - Sustainability, defined as whether the tax-to-GDP ratio does not go back to its initial (or lower) level in the four-year window immediately after the episode ends.

- Of all combinations of tax handles,[6] the most amenable to international benchmarking is the direct taxes component.

---

[4] Although data is available for 2020 (and in some cases for 2021), they are likely to be affected by the COVID-19 pandemic and are not included in the sample.

[5] In addition, an episode must start with a positive increase in the tax-to-GDP ratio.

[6] Revenues from mining do not necessarily have a direct relationship to GDP, as do tax revenues, so they are better assessed on a project-by-project basis. *Corrective*, or excise taxes, can be relatively well estimated using the characteristics of the tax (i.e., for the carbon tax, the amount per ton of carbon content in a fuel), the consumption of the excisable good (i.e., consumption of fossil fuels), and the behavioral response (i.e., the price elasticity of consumption of fossil fuels), so there is less need to do an international benchmarking. See 2022 Selected Issues Paper *Climate Policies for a Successful Green Transition* for an assessment of revenue increases from green taxes and other climate policies.

- For the tax reform proposal in Chile, this includes measures on PIT, CIT, and wealth taxes, including tax expenditures and reduction of exemptions. In terms of the comparison group of OECD countries, the exercise includes PIT, CIT, and property taxes.
- The effect of tax administration measures is difficult to assess, so the exercise is done both with and without them.
- The direct tax component of the tax reform assumes a yield in year four of:
  - 2.7 percent of GDP (0.68 per year on average) with tax administration measures.
  - 1.1 percent of GDP (0.28 per year on average) without those measures.

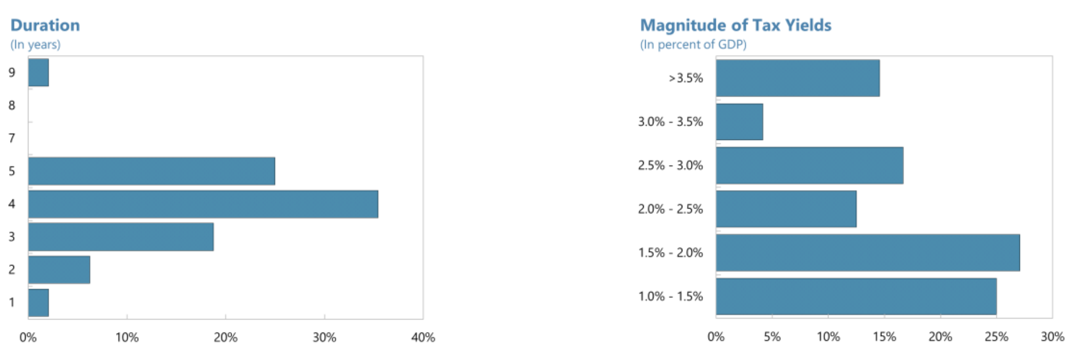
- A robustness check is made using data from 1990 to 1999 to assess whether OECD countries did more intensive revenue mobilization earlier in their development phase.
- In addition, the identified episodes are correlated with instances of recorded tax reforms on CIT, PIT and property taxes using the IMF Tax Measures Database. A large majority of the episodes indeed coincide with episodes of tax reforms, which gives a degree of confidence on the analysis. However, the country coverage of the Tax Measures Database is less comprehensive (Akitoby and others, 2018).

Benchmarking – Direct Taxes Excluding Tax Administration Measures

14. Excluding tax administration measures, increases of similar magnitude and duration as in Chile's proposed reform of direct taxes have been relatively common in the OECD. For OECD countries, 48 similar episodes can be identified, in which the direct-tax-to-GDP ratio increased by 0.28 percentage points on average per year over a four-year period. In most of the episodes, direct tax revenues increased between 1 and 2 percent of GDP over 3 to 5 years, although in around 15 percent of cases the increase was larger than 3.5 percent. The average duration of episodes was 4.2 years, with an average yield of 2.2 percent of GDP.

Frequency of Duration and Tax Yields from Revenue Mobilization Episodes in OECD Countries, 2000–2019

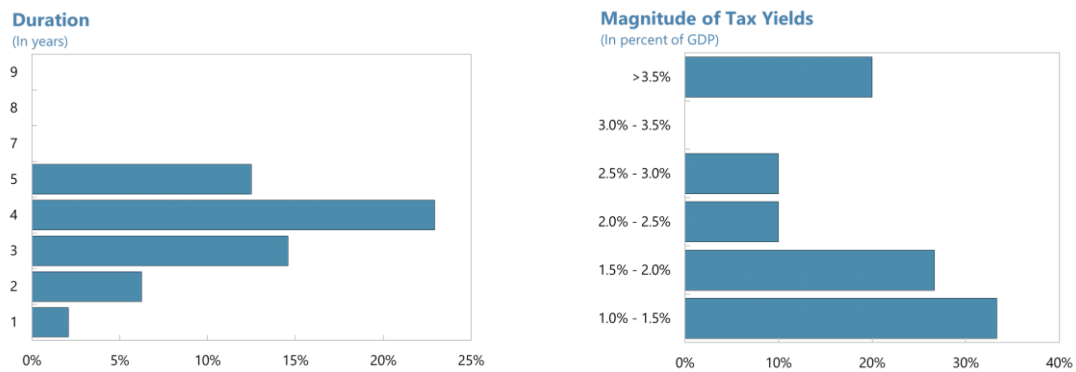
(In percent of total episodes)



Sources: WORLD database and IMF staff estimates.

15. Considering only sustainable episodes (as defined above), the number of similar episodes drops to 30. Of the remaining 18 episodes, 10 can be classified as non-sustainable (meaning that the direct-tax-to-GDP ratio decreased in the window immediately after the episode ended), and 9 episodes are indeterminate because they are too recent (i.e., the next window closes after 2020, which lies outside of the sample). This suggests that a substantial share of revenue mobilization episodes was not successful in the medium term. Although the average duration of the sustainable episodes was slightly lower, at 3.8 years, the average yield was similar to the average of the full sample.

Frequency of Duration and Tax Yields from Sustainable Revenue Mobilization Episodes in OECD Countries, 2000–2019
(In percent of total episodes)



Sources: WORLD database and IMF staff estimates.

16. Including data from the decade of the 1990s adds 28 additional similar episodes. Interestingly, all but one episode for this decade are sustainable. Episodes are on average slightly shorter, but not significantly so (the simple average of duration is 3.9 years), and the average yield is 2.7 percent of GDP, 0.5 percentage points higher than in the original sample. As expected, both average duration and average yield remain unchanged.

Benchmarking – Direct Taxes Including Tax Administration Measures

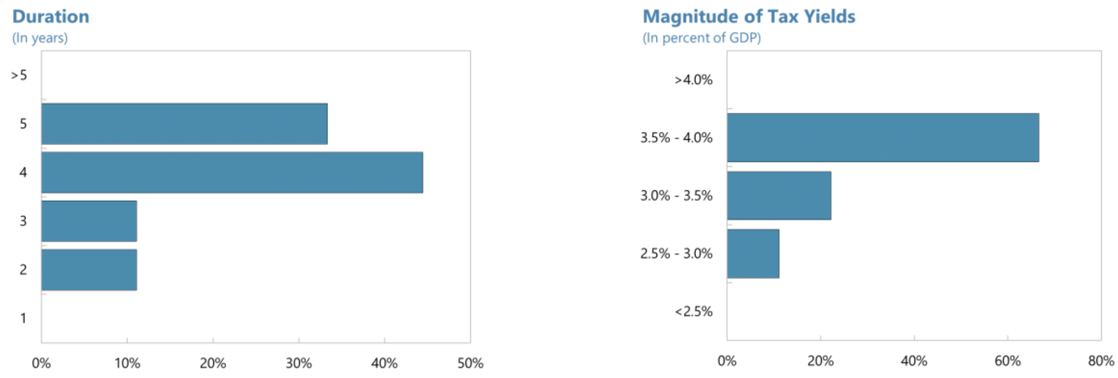
17. Only 9 episodes are identified for OECD countries in which the direct-taxes-to-GDP ratio increased by at least 2.7 percentage points over the four-year period. Most of the duration of these episodes are between 4 and 5 years, and the yield is concentrated in the range between 3.5 and 4 percent of GDP. The average yield is 3.6 percent of GDP, and the average duration is 4 years.

18. Considering only sustainable episodes, the number of similar episodes is further reduced to 6. Most of the duration of these episodes are between 4 and 5 years (with the average duration at 3.7 years). All yields lie between 3.5 and 4 percent of GDP (with the average yield at 3.8 percent of GDP).

19. Similar to the results with the full sample, in the 1990s decade, the number of similar episodes is significantly reduced from 28 additional episodes to 8. These 8 episodes have an average duration of 3.9 years and an average yield of 4.3 percent of GDP, and all of them are classified as sustainable.

Frequency of Duration and Tax Yields from Revenue Mobilization Episodes in OECD Countries, 2000–2019

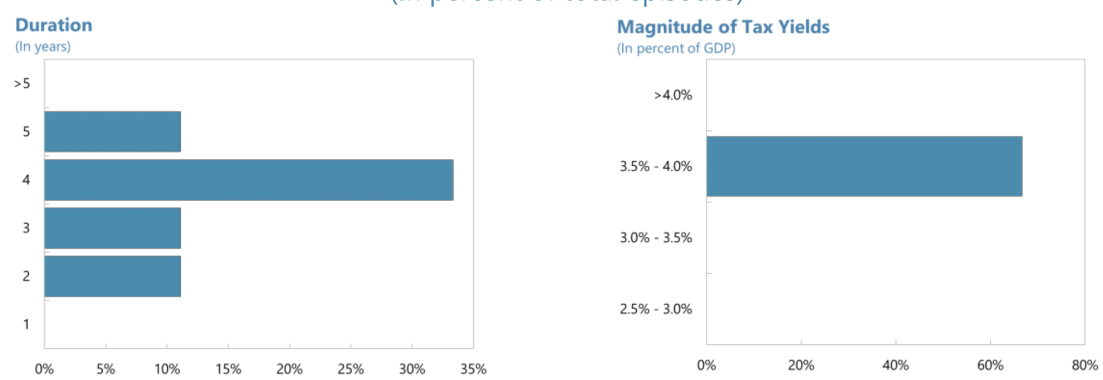
(In percent of total episodes)



Sources: WORLD database and IMF staff estimates.

Frequency of Duration and Tax Yields from Sustainable Revenue Mobilization Episodes in OECD Countries, 2000–2019

(In percent of total episodes)



Sources: WORLD database and IMF staff estimates.

20. Measuring the yields of tax administration measures is particularly difficult. The benchmarking exercise does not speak to the feasibility of the revenue increases estimated from tax administration measures, but rather to the overall magnitude of the effects of all measures combined. Recent IMF research by Chang and others (2020 and 2022) suggest that a country with

stronger tax operational capacity collects significantly more tax revenues.[7] They find that among tax administration characteristics, compliance risks management, use of third-party data, public accountability and transparency, the presence of a Large Taxpayer's Office, timely filing of tax declarations, and support for voluntary compliance play a significant role in increasing revenue. Akitoby and others (2018) also suggest that (i) multi-pronged tax administration reforms often go hand in hand with tax policy measures; and (ii) sustaining revenue gains hinges on efforts in the key compliance areas (risk-based audits, registration, filing, payment, and reporting). However, experience based on IMF Technical Assistance suggests that it is rare to see yields of over 0.5 percent of GDP from tax administration measures.

21. There are other downward risks to the revenue potential of the reform. The government's proposal rightly targets the highest wealth levels and a broad base of assets. However, the international experience shows that wealth taxes have been difficult to implement and have traditionally underperformed in revenue potential. An alternative would be to consider increasing property taxation, including by ensuring that property values are properly assessed and frequently updated. The reform proposal also includes various tax incentives to CIT. For instance, companies can credit up to two percentage points of CIT with *productive* investments. Revenue estimates in the tax plan assume firms will only use half of the credit, but it can be expected instead that firms will try to use as much as possible of the tax credit. These incentives should be regularly assessed and, if found not to be cost-effective, phased out.

22. Over the medium term, additional tax policy measures can be considered to mobilize revenues and further increase the progressivity and fairness of the tax system in Chile. The pillar on green taxes (forthcoming) has a strong potential not only to deliver on the authorities' ambitious and worthwhile climate goals, but also to increase revenues. Revenue collection (of up to 2 percent of GDP by 2030) can be recycled for targeted transfers and investment to protect the most vulnerable households and boost potential growth (see 2022 Selected Issues Paper on *Climate Policies for a Successful Green Transition*). On PIT, gradually lowering the exempt threshold could significantly increase the coverage of the tax, while still protecting poorer households. Discussions are also ongoing to modify mining taxes, which are a significant source of income (see Box 1).

E. Revenue Scenarios and Fiscal Consolidation

23. The authorities are firmly committed to their medium-term fiscal consolidation plan. The plan aims to achieve a broadly balanced structural fiscal position and keep public debt below 45 percent of GDP over the medium term. This entails a structural fiscal consolidation effort of around 2.1 percent of GDP from the 2023 structural Budget target.[8]

[7] Those results are not directly applicable to the benchmarking exercise, as they estimate the effects of stronger tax administration on total tax revenue, including most importantly VAT revenue. In addition, Chile already has a mature tax authority, and VAT revenues are high.

[8] The consolidation effort on the basis of the headline fiscal balance is closer to 3 percent of GDP.

Authorities' Medium-Term Fiscal Consolidation Plan
(In percent of GDP)

	2023	2024	2025	2026	2027
Cyclically adjusted Fiscal Balance	-2.1	-1.8	-1.1	0.3	0.0

Source: Ministry of Finance, *Informe de Finanzas Públicas*, 2022Q3.

Box 1. Mining Taxes

IMF Technical Assistance assessed that, relative to other mining fiscal regimes, the government take in Chile is in the middle to lower half of the distribution across countries. Moreover, the low break-even price contributes to a competitive investment climate, with the government take increasing with profitability. Among other factors, high copper prices and the potential for a significant and sustained increase in demand for copper in the medium term due to the global energy transition has led to discussions on the need for the mining sector to increase its fiscal revenue contributions.

After a protracted debate in Congress, a new proposal for changes to mining taxes was announced at the end of October. The project includes introducing an ad-valorem royalty, with a flat structure at a moderate rate of 1 percent. A simple and moderate royalty can ensure that the government receives early and dependable revenues. The profits-based component (*Impuesto Específico a la Minería*) maintains the current structure, with the rate of the tax increasing as the operating margin increases, but with higher marginal tax rates. This structure is attractive for investors because they will only pay more when their profits are higher; in other words, it is a progressive fiscal element.

24. The tax reform is needed to finance social spending and meet the authorities' fiscal consolidation plan. The tax reform aims to finance additional social spending, which lags behind OECD peers (Box 2). The universal minimum pension (PGU) approved in March 2022 entails additional net spending of about 0.8 percent of GDP per year,[9] while the expansion proposed in the draft pension reform would cost an estimated extra 0.44 percent of GDP.[10] Assuming the total tax reform yields the increase in revenues projected by the authorities, the increase in fiscal space would be around 1.4 percent of GDP (Column 1, next table), which would be sufficient to finance the proposed expansion of the PGU. Assuming a more conservative (but still ambitious) yield from tax administration measures, the increase in fiscal space declines to 1.0 percent of GDP (Column 2, next table). However, assuming a yield from tax administration measures commensurate with international experience as reported by IMF Technical Assistance (of 0.4 percent of GDP), additional expenditure rationalization or revenue mobilization measures would need to be identified to achieve the full fiscal consolidation and finance the proposed expansion of the PGU (Column 3, next table).

[9] The PGU entails additional spending of 2.2 percent of GDP, financed by a rationalization of tax exemptions introduced in 2022 (0.6 percent of GDP) and the discontinuation of the solidarity pension (1.1 percent of GDP). The expansion proposed in the draft pension reform would cost an estimated 0.44 percent of GDP per year.

[10] The additional spending in the PGU estimated in the financial report that accompanies the pension reform ("Informe Financiero No.201/07.11.2022", table 14, page 29) is 1,531 billion CHP (in real 2022 CHP) for 2027. Assuming the same inflation rate and GDP path as in the macroeconomic framework for the 2023 Budget, the estimated cost is about 0.44 percent of GDP.

Revenue and Fiscal Consolidation Scenarios (In percent of GDP)			
	Authorities' tax reform scenario (1)	Conservative tax administration yield (2)	Realistic tax administration yield (3)
Structural fiscal consolidation effort in authorities' medium-term plan	2.1	2.1	2.1
Revenues	3.5	3.1	2.5
Of which:			
Direct taxes	1.1	1.1	1.1
Tax administration	*1.6*	*1.1*	*0.5*
Royalty	0.5	0.5	0.5
Corrective taxes	0.3	0.3	0.3
Additional spending consistent with fiscal consolidation	1.4	1.0	0.4
Of which:			
PGU approved in March	0.8	0.8	0.8
PGU proposed expansion	0.44	0.44	0.44
Net effect of all tax measures and expansion of PGU	0.16	-0.24	-0.84
Sources: Ministry of Finance and IMF staff estimates.			

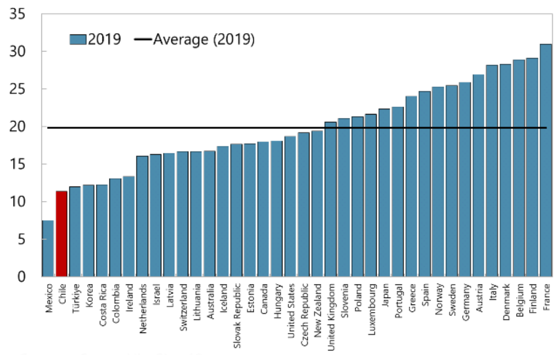
25. It is also important to consider that the increase in taxes will have implications for growth, with the effect depending on the final composition of the tax and spending reforms.[11] Empirical studies have generally found that CIT and PIT are relatively more harmful for growth than consumption and property taxes. Acosta and Yoo (2012) and De Mooj and others (2020) find that raising taxes on income, while reducing consumption and property taxes and keeping the overall tax burden unchanged, is negatively associated with growth. At the same time, income taxes tend to reduce inequality more than consumption taxes. This suggests a trade-off between growth and equity in choosing the tax composition, even before considering the effects of additional spending. Empirical evidence suggests that public spending in R&D and in education can boost investment and innovation, leading to higher growth. Martínez and others (2017) find that, using household-level data for Chile, social spending on basic and secondary education and health lead to lower inequality and poverty. Candia and Engel (2018), using similar data, find that transfers in education, specially at the primary and secondary levels, and in health reduce inequality.

[11] The Ministry of Finance estimates the tax and spending reform could increase GDP per capita by 1.8 percent over the medium term, with a negative effect of 2.7 percent from higher taxes and a significant and positive effect of 4.5 percent from additional social and other spending.

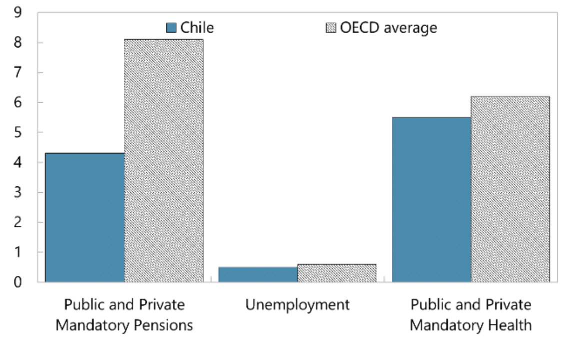
Box 2. Social Spending in Chile and OECD Countries

Total social spending in Chile lags OECD countries. Using data for 2017 (the latest available year), total social spending in Chile was below the OECD average by more than 8 percent of GDP. Spending in pensions (considering both public and private mandatory spending) was in 2017 almost 4 percent of GDP below the OECD average, while total spending in health was 0.7 percent of GDP below (these figures are before the increases in the PGU and the draft pension reform).

Total Public Social Expenditure, 2019
(In percent of GDP)



Social Spending, 2017
(In percent of GDP)



Sources: OECD Social Expenditure database, and IMF staff estimates.

F. Conclusions

26. The tax reform is needed to finance fiscal consolidation and increase social spending, but the expected revenue yields are subject to a high degree of uncertainty. The tax reform is ambitious, wide-ranging, and targeted at increasing progressivity and reducing inequality. Benchmarking the expected yields against similar episodes in OECD countries suggests that increasing revenues by 2.7 percent of GDP over four years from direct taxes (PIT, CIT, and property taxes) is feasible, but rare. The target for direct taxes, without including gains from tax administration, seems feasible based on many similar episodes in the OECD.

27. Including the effects of tax administration measures significantly reduces the number of comparable episodes in the international benchmarking exercise. In addition, IMF Technical Assistance experience suggests that tax administration reforms only occasionally yield more than 0.5 percent of GDP, although the exact yield depends on the specific measures and the capacity of the tax administration. Experience with wealth taxes suggests that they have frequently underperformed in terms of collection and have been scaled down or eliminated in some countries. In addition, tax expenditures might materialize with a high probability, so their cost-effectiveness should be regularly analyzed.

28. Sequencing social spending reforms conditional on revenue performance will be key to maintaining sustainability while boosting inclusive growth. Social spending and spending on innovation-boosting measures could counter the negative impact of higher taxes on growth. An adequate tax and social spending strategy will also foster inclusive growth by lowering risks of social unrest that are not captured in standard growth models. However, the uncertainty of revenue yields,

particularly from tax administration and wealth taxes, suggests that spending reforms should be sequenced to maintain fiscal sustainability. Under a realistic scenario on the yield from tax administration measures, additional revenue or spending measures would be needed to both meet fiscal consolidation goals and finance the expansion of the PGU.

29. Future tax reform efforts could focus on boosting revenue and further increasing the progressivity and fairness of the tax system. Consideration should be given to gradually increasing the carbon tax and the excise tax on diesel, lowering the exempt threshold of the PIT to bring more taxpayers in the tax net, and increasing the efficiency of property taxes by ensuring fiscal valuation accurately reflects property values, among other measures.

References

Abdel-Kader, K. and De Mooij, R., 2020. " Tax Policy and Inclusive Growth," IMF Working Paper WP/20/271.

Acosta-Ormaechea, S. and Yoo, J., 2012. "Tax Composition and Growth: A Broad Cross Country Perspective," IMF Working Paper WP/12/257.

Adan, H., Bedhat, J.M., Soon Chang, E., Gavin, E., Gueorguiev, N., Honda, J. and Nose, M., forthcoming. "Revisiting the Revenue Gains from Tax Administration Reforms," forthcoming IMF Working Paper.

Martínez-Aguilar, S., Fuchs, A., Ortiz-Juarez, E., and Del Carmen, G., 2017. "The Impact of Fiscal Policy on Inequality and Poverty in Chile," CEQ Working Paper WP 46.

Akitoby, B., Baum, A., Hackney, C., Harrison, O., Primus, K., and Salins, V., 2018, "Tax Revenue Mobilization Episodes in Emerging Markets and Low-Income Countries: Lessons from a New Dataset," IMF Working Paper WP/18/234.

Candia, B. and Engel, E., 2018. "Taxes, Transfers and Income Distribution in Chile," CEQ Working Paper WP 82.

Hadzi-Vaskov, M. and Ricci, L., 2021. " Understanding Chile's Social Unrest in an International Perspective," IMF Working Paper WP/21/174.

Soon Chang, E., Gavin, E., Gueorguiev, N., Honda, J., 2020. "Raising Tax Revenue: How to Get More from Tax Administrations?," IMF Working Paper WP/20/142.